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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 684

**GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, PETITIONER**

VS.

RICHARD J. REYNOLDS

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FOURTH CIRCUIT**

PETITION FOR CERTIORARI FILED JANUARY 7, 1941

CERTIORARI GRANTED FEBRUARY 17, 1941

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH
CIRCUIT

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Before United States Board of Tax Appeals

Docket No. 94108

RICHARD J. REYNOLDS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: J. G. Korner, Jr., Esq., H. G. Hudson, Esq., Stratton Coyner, Esq. For Comm'r: Rollin H. Transue, Esq.

Docket entries.

Mr. Sternhagen, April 12, 1939.

1938

- June 3—Petition received and filed. Taxpayer notified. (Fee paid.)
- June 3—Copy of petition served on General Counsel.
- July 26—Answer filed by General Counsel.
- July 26—Request for Circuit hearing in Washington, D. C., filed by General Counsel.
- Aug. 2—Notice issued placing proceeding on Washington, D. C., calendar. Answer and request served.

1939

- Jan. 11—Hearing set March 2, 1939.
- Feb. 14—Motion for a continuance to April 17, 1939, filed by taxpayer. February 15, 1939, granted.
- Apr. 12—Stipulation to submit on the filing of the attached stipulation of facts together with certain exhibits filed.
- Apr. 12—Stipulation of facts filed.
- Apr. 12—Order assigning this proceeding to Div. 10, Mr. Sternhagen, for fixing of time for briefs and for report, entered.
- Apr. 19—Agreed motion for designation of time to file briefs: June 15 for petitioner's brief; 15 days thereafter for respondent's brief; and 15 days for taxpayer to reply if he so desires; filed.
- Apr. 20—Agreed motion for designation of time to file briefs granted. Let briefs be filed at time requested.
- June 5—Brief filed by taxpayer. June 6, 1939, copy served.
- June 20—Reply brief filed by General Counsel.
- June 24—Reply brief filed by taxpayer. June 24, 1939, copy served.

1940

- Jan. 10—Opinion rendered, John M. Sternhagen, Div. 10. Decision will be entered for the respondent.
- Jan. 11—Decision entered, J. M. Sternhagen, Div. 10.
- Feb. 23—Motion to fix the sum of supersedeas bond at \$49,123.98 filed by taxpayer.

1940

- Feb. 23—Order fixing amount of bond at \$50,000 entered.
Mar. 14—Supersedeas bond in the sum of \$50,000.00 approved and ordered filed and power of attorney.
Mar. 25—Petition for review by U. S. Circuit Court of Appeals (4) with assignments of error filed by taxpayer.
Mar. 25—Proof of service filed.
Mar. 26—Praecipe for record filed with proof of service thereon.

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Before United States Board of Tax Appeals

[File endorsement omitted.]

Docket No. 94108

RICHARD J. REYNOLDS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed June 3, 1938

Comes now the petitioner and petitions the Board for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (It: C: 1: NFP: 90D), dated March 11, 1938, and as a basis of this proceeding alleges as follows:

1. The petitioner, an individual taxpayer, is a citizen of the State of North Carolina and resides in Winston-Salem, North Carolina, and filed his income-tax return for the year 1934 in the office of the Collector of Internal Revenue for the District of North Carolina.
2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on March 11, 1938.
3. The tax in controversy is income tax for the calendar year 1934, and is in the amount of \$33,878.61.
4. The determination of tax as set forth in the said deficiency notice is based upon the following errors:
 - (a) The Commissioner erred in that in computing gain or loss upon the sale of certain personal property he used, as the basis for such computation, an adjusted value of the said personal property as of the date of the death of petitioner's father, who died on July 19, 1918, instead of using, as such basis, the fair market price or value of such property at the time of its acquisition by the petitioner, which was on April 4, 1934.

(b) The Commissioner erred in mis-stating the provisions of the statute in his statutory deficiency notice of March 11, 1938. In his said notice (at page 2 thereof) the Commissioner stated:

"Under the will of your father who died in 1918, certain securities of the estate were to be held in trust for you by the Safe Deposit and Trust Company, Baltimore, Maryland, until you became 28 years of age, which was April 4, 1934. Some of the securities received when the trust was distributed to you in 1934 were sold by you in 1934, and in computing the profit or loss sustained, you used as cost the market value on the date of distribution, April 4, 1934, whereas according to section 113 (a) (5) of the Revenue Act of 1934, the basis to be used in the case of a sale is the value at the date of death * * *"

whereas the said section of the statute provides that:

"If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition."

The determination of the Commissioner in his said notice is not in accordance with the provisions of the statute and is erroneous.

(c) The Commissioner erred in holding that the basis for computing gain or loss in this case is the value at the date of death of petitioner's father in 1918, for the reason that until April 4, 1934, petitioner's interest in the trust corpus was merely contingent and expectant, and petitioner did not acquire a substantial ownership in the trust corpus until the happening of the contingency which gave rise to petitioner's ownership in a portion of the assets comprising the corpus of the trust; and that only upon the happening and fulfillment of the said contingency did petitioner acquire ownership of the property which was sold by the petitioner in 1934.

4 5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) R. J. Reynolds (senior), father of the petitioner, died on July 19, 1918, leaving four infant children surviving him. Petitioner, the oldest of said children, was born April 4, 1906, and was approximately 12 years of age at the date of his father's death.

(b) R. J. Reynolds (senior) died leaving a last will and testament which was duly admitted to probate and which was duly administered in accordance with its terms. Portions of the said will which are pertinent and material in this cause are attached hereto and made a part hereof as Exhibit B.

(c) In his said last will and testament the decedent, after making certain bequests and devises not material in this cause, gave, devised, and bequeathed two-thirds of his estate of every kind, character, and description, to Safe Deposit & Trust Company of Baltimore, Maryland, as Trustee, to hold, dispose of, and distribute, upon certain terms and conditions, for the benefit of decedent's four children.

(d) The trust created by the said will of the decedent directed the trustee:

1. To apply so much of the trust income as was deemed necessary for the support, maintenance, and education of each child until each such child should arrive at the age of 21 years;

2. From and after the date each child should arrive at the age of 21 years and until each such child should attain the age of 28 years, the Trustee was authorized and directed to pay annually to each child not less than \$5,000 and not more than

5 \$50,000, out of the trust income of such child;

(3) The balance of the income, over and above the amounts so paid as aforesaid, was directed to be accumulated by the Trustee for each such child until such child should attain the age of 28 years at which time "each of them shall become entitled to and shall respectively receive from said Trustee" a portion of the corpus of the trust together with the accumulated income thereon;

(4) To encourage habits of industry, thrift and economy in the children, the Trustee was directed to pay to each child (who had attained the age of 21 years but had not attained the age of 28 years) \$2.00 for every \$1.00 made or saved by such child in legitimate business or investments (but not in speculation on margin in "futures"); with the further provision that such payment should be made in cash or securities up to the full extent of the trust property administered for the benefit of such child;

(5) In the event any child should die before arriving at the age of 28 years, then the share of the trust "which would have been payable to him or her, had he or she arrived at that age," to be held by the Trustee for the benefit of, and the income paid to, the devisee of such child until the time when such child would have arrived at the age of 28 years if he had lived, at which time the trust should cease and the estate should become payable to such devisee;

(6) But should any child die intestate before reaching the age of 28 years, leaving surviving issue, the share of the trust estate to which he would have become entitled if he had lived to be 28 years of age, was to continue to be held by the Trustees

6 in trust, for the benefit of, and the income applied to the support and maintenance of, the surviving issue of such deceased child, until the time when the deceased child would have arrived at the age of 28 years if he had lived; at which time the trust should cease "and the estate shall then become vested" in such surviving issue;

(7) But should any child die intestate before reaching the age of 28 years, and without issue living at the termination of the trust, then the trust should continue, and be held by the Trustee, on like trusts for the benefit of the surviving brothers and sisters of such deceased child and the then living issue of any deceased brother or sister per stirpes.

(8) If each and all of the children of testator should die without having attained the age of 28 years and without issue surviving at the termination of the trust, then and in that event one-half of the trust estate should go to and belong to the wife of the testator and the other one-half to the living brothers and sisters of the testator and the living descendants of any deceased brothers and sisters, per stirpes.

(e) The said will and testament of decedent provided for the substitution of a trustee or trustees and directed that, "so often as any new Trustee, or Trustees, shall be substituted or appointed, as aforesaid, all the property, real, personal, and mixed of every nature and kind whatsoever and wherever situated, which shall be held upon the trusts herein created, shall be conveyed, assigned, and transferred, respectively, in such manner that the same shall become legally and effectually vested in the new Trustee, or Trustees."

7 (f) The Trustee, Safe Deposit & Trust Company, took over the assets of the trust and administered them under the terms of the trust, and so continues to administer the said trust to the present date.

(g) One son of testator died in 1932, before reaching the age of 21 years, leaving an infant child approximately 2 years of age and another child in ventre sa mere who was born about six months thereafter. At the date of his brother's death petitioner was 26 years of age.

(h) Petitioner attained to the age of 28 years on April 4, 1934, and on said date became entitled to a portion of the corpus of the trust which became vested in him on said date.

(i) Prior to April 4, 1934, the interest of petitioner in the trust corpus was contingent and did not constitute a substantial ownership of the trust corpus, and the ownership of a substantial interest or estate in the said corpus was not acquired by petitioner until April 4, 1934.

(j) At the date of the death of the father of petitioner, the interest of petitioner was only the right to receive income from the trust, under certain prescribed conditions, until he should attain the age of 28 years, or until he should die prior to attaining that age; that in the event he should die prior to attaining the age of 28 years, he could come into no interest or estate in the trust corpus; that upon the condition and in the event he should attain to the age of 28 years he would acquire an interest and estate in the said trust corpus; that unless and until the happening of the said condition precedent (viz, attaining to the age of 28 years), no ownership, right, dominion, control, interest, or estate in the trust corpus was acquired by petitioner or vested in him; that at the date of the death of his father petitioner was 12 years
8 of age, and his interest was contingent and expectant only, and was too insubstantial and remote to constitute the acquisition by him of the ownership of the trust corpus.

(k) To hold that petitioner acquired the ownership of the trust corpus at the date of his father's death in 1918 would be inconsistent and unreasonable and directly opposite to the letter, spirit, and purpose of section 113 (a) (5) of the Revenue Act of 1934, and of all prior revenue acts containing the same provision as that said section; that so to hold would achieve the very opposite of what Congress intended by the enactment of said section, and would cause absurd, illogical, and inconsistent results.

(l) To hold that petitioner acquired the ownership of the trust corpus at the date of his father's death in 1918 would be contrary to law and the authoritative and controlling decisions relative thereto.

(m) To hold that petitioner acquired the ownership of the trust corpus at the date of his father's death in 1918 would be contrary to the laws of the State of North Carolina controlling and governing the property rights and estates of both the petitioner and his father, citizens and residents of the State of North Carolina.

(n) To hold that petitioner acquired the ownership of the trust corpus at the date of his father's death in 1918, would be contrary to, and violative of, the long-continued administrative and legislative history, interpretation, and administration of the section, and its identical predecessor sections in the statutes.

(o) Petitioner attained to the age of 28 years on April 4, 1934, and on that day occurred the event, prescribed by the trust, giv-

ing rise to ownership in petitioner of a certain portion of the trust corpus, and on said date petitioner acquired the ownership thereof.

9 (p) In accordance with the authority and direction contained in the trust instrument, the trustees transferred, delivered, and distributed to petitioner the portion of the assets comprising the corpus of the trust, which were acquired by petitioner on April 4, 1934, among said assets being certain stocks and securities.

(q) Thereafter, and in the said year 1934, the petitioner sold certain of the said stocks and securities acquired by him on April 4, 1934, as aforesaid.

(r) In his income-tax return for the said year 1934, petitioner reported the said sales made by him, and in computing the gains and losses arising upon such said sales, the petitioner compared the sales price received by him in said sales with the statutory basis thereof which was the fair market value of such said property at the time of his acquisition thereof, viz, the fair market value of such said property on April 4, 1934, and computed and reported his taxable income accordingly.

(s) The respondent has determined (and has so advised petitioner in his statutory notice of deficiency, Exhibit A, attached hereto) that the basis to be used by petitioner in computing his gains and losses on said sales is the value at the date of the death of petitioner's father; whereas such said determination is not in accordance with the terms of the statute, which provides that the basis shall be the fair market value at the date of acquisition of the property by petitioner.

(t) The petitioner correctly computed and reported his taxable income arising upon the sales made by him of the property acquired by him on April 4, 1934, and such computation and report was in accordance with the express provisions of the statute.

10 (u) The action of the respondent in determining that, in the sales involved in this cause, the basis is the value at the date of the death of petitioner's father, was erroneous and was not in accordance with the statute or with law, but is violative of law and of the taxing statute, and is violative of the Sixteenth Amendment in that it purports to compute and impose an income tax upon property which is not income, and in that, under the guise of an income tax, its effect is wrongfully and illegally to extract and take from the petitioner a portion of his capital.

(v) The action of the respondent is unwarranted and illegal and is without authority or support of, and is violative of, the basic law, the Revenue Act, the controlling judicial authorities, the laws of the State of North Carolina, and the long continued

administrative and legislative history and interpretation which has received repeated legislative approval and adoption by re-enactments in light thereof—and more particularly by the enactment of section 113 (a) (5) of the Revenue Act of 1934, in light of such history, interpretation and administration.

Wherefore, Petitioner prays the Board to hear his said appeal and to find, determine and order that there is no deficiency due from the petitioner for the year 1934.

(s) J. G. KORNER, Jr.,
J. G. Korner, Jr.,

Transportation Building, Washington, D. C.

(s) H. G. HUDSON,
H. G. Hudson,

Wachovia Bank Building, Winston-Salem, N. C.

(s) STRATTON COYNER,
Stratton Coyner,

Reynolds Building, Winston-Salem, N. C.

Attorneys for Petitioner.

11 [Duly sworn to by Richard J. Reynolds; jurat omitted in
printing.]

12 *Exhibit A to petition*

IT:C:1.
NFP:90D.

MAR. 11, 1938.

MR. RICHARD J. REYNOLDS,
1206 Reynolds Building,
Winston-Salem, North Carolina.

SIR: You are advised that the determination of your income tax liability for the taxable year ended December 31, 1934 discloses a deficiency of \$33,878.61 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1: P-7. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest

Respectfully,

By (Signed) JOHN R. KIRK,

**Statement.
Form 870.
Exhibit A.**

STATEMENT

MR. RICHARD J. REYNOLDS

1206 Reynolds Building, Winston-Salem, North Carolina

TAX LIABILITY FOR TAXABLE YEAR ENDED DECEMBER 31, 1934

In making this determination of your income tax liability careful consideration has been given to the internal revenue agent's reports dated March 2, 1936 and March 8, 1937; to your protest filed April 27, 1936; and to the statements made at the conference held on April 27, 1936.

A copy of this letter, together with a copy of the statement, has been mailed to your representative, Mr. Stratton Coyner, Reynolds Building, Winston-Salem, North Carolina.

ADJUSTMENTS TO NET INCOME—1934

Net income as disclosed by return	\$313,900.27
Unallowable deductions and additional income:	
(a) Capital net gain not agreed to	61,027.63
agreed to	1,426.91
(b) North Carolina Sales taxes	677.38
(c) Loss on worthless stocks	45,220.00
(d) Excessive depreciation	427.34
(e) Legal fees and commissions	8,374.02
(f) Interest on gold deposits	3,278.57
Total	\$434,341.12
Nontaxable income: (a) Nontaxable dividends	100.00
Net income adjusted	\$434,241.12

EXPLANATION OF ADJUSTMENTS

You have agreed to the adjustments (b) to (g), inclusive, and to changes in capital net gain amounting to \$1,426.91, and the resulting deficiency in tax of \$31,022.32, has been assessed. These changes are fully explained in the revenue agent's reports referred to above, which are hereby made a part of this letter.

With reference to the increase in capital net gain not agreed to, \$61,027.63, it consists of three items, as follows:

		<i>Increase</i>
(1) Loss reported.....	\$29,536.13	
Corrected gain.....	2,275.61	
		\$31,811.74
(2) Gain reported.....	\$4,555.00	
Gain corrected.....	12,454.09	
		7,899.09
(3) Loss reported.....	\$21,092.50	
Gain as corrected.....	224.30	
		21,316.80
Net increase not agreed to.....		\$61,027.63

Under the will of your father who died in 1918, certain securities of the estate were to be held in trust for you by the Safe Deposit and Trust Company, Baltimore, Maryland, until you became 28 years of age, which was April 4, 1934. Some of the securities received when the trust was distributed to you in 1934 were sold by you in 1934, and in computing the profit or loss sustained, you used as cost the market value on the date of distribution, April 4, 1934, whereas according to section 113 (a) (5) of the Revenue Act of 1934, the basis to be used in the case of a sale is the value at the date of death or the cost to the trustee if the securities were acquired by the trust by purchase subsequent to the date of death. The correct computation of the profit under item (1) above, is as follows:

16	Security	Date acquired	Cost or value	Date sold	Received	Profit or loss	% tax-able	Taxable profit or loss
	Baltimore City Sewer	Sept. 9, 1927	\$50,942.75	Apr. 10, 1934	\$54,062.50	\$3,218.75	40	\$1,287.50
	New Jersey Highway	Aug. 6, 1930	\$23,877.28	Apr. 12, 1934	1,089,070.04	59,682.90	60	23,899.79
		Sept. 30, 1930	126,704.77					
		Oct. 2, 1930	144,770.92					
		Apr. 1, 1931	15,662.50					
	Maryland Bridge	Oct. 24, 1930	297,275.18					
	Maryland Lateral and Post Road	Aug. 31, 1927	7,262.11	June 15, 1934	7,000.00	(262.11)	40	(100.84)
	Kingdom of Great Britain and Ireland	Aug. 31, 1927	24,864.41	June 15, 1934	24,000.00	(864.41)	40	(345.76)
	State of Maryland Trunk Lines Road	Apr. 17, 1934	474,112.50	Apr. 18, 1934	467,338.40	(6,774.10)	100	(6,774.10)
	State of Maryland Construction Loan of 1922	Apr. 13, 1934	585,772.50	Apr. 14, 1934	578,394.61	(7,377.89)	100	(7,377.89)
	State of Maryland Construction Loan of 1927	Oct. 6, 1922	5,130.55	Aug. 15, 1934	5,000.00	(130.55)	30	(41.87)
	U. S. Liberty Loan	Oct. 6, 1922	4,110.84	Aug. 15, 1934	4,000.00	(110.84)	30	(33.25)
	State of California	Aug. 26, 1927	27,011.27	Aug. 15, 1934	27,000.00	(11.27)	40	(4.51)
	U. S. Treasury	June 1, 1921	1,000.00	Sept. 26, 1934	1,002.50	2.50	30	0.75
		July 17, 1931	274,369.43	Oct. 17, 1934	260,650.00	(13,719.43)	60	(8,231.66)
		July 18, 1932	13,056.00	Apr. 7, 1934	12,866.00	(190.00)	80	(80.00)
		Dec. 11, 1933	92,746.33	Apr. 7, 1934	185,734.34	527.45	100	527.45
		Jan. 9, 1934	2,422.46	Apr. 7, 1934				
		Jan. 11, 1934	13,113.75	Apr. 7, 1934				
		Jan. 15, 1934	23,800.97	Apr. 7, 1934				
		Jan. 17, 1934	3,023.56	Apr. 7, 1934				
	Total							\$2,275.61
	Loss as reported							29,536.13
	Increase in income							\$31,811.74

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(2) You reported a profit of \$4,555.00 on the sale of 1,000 shares of R. J. Reynolds Tobacco Co. "B" stock which was part of the 2,000 shares in the trust created under the will of your father. In computing the cost you used, as under item (1) above, the value of April 4, 1934, the date the stock was delivered to you by the trust whereas the value at the date of death represents the cost to you. On account of various stock dividends, sales and other changes the 2,000 shares had by 1934 become 203,543 shares with a book value of \$865,831.66. The cost of and the profit on the 1,000 shares sold in 1934 has been computed as follows:

Acquired or sold	Common "A"	Common "B"
December 30, 1918—Transferred from estate of R. J. Reynolds to trust for R. J. Reynolds, Jr.	4,207	2,000
December 6, 1920—From estate to trust		64
August 31, 1920—4 new for 1 old	16,828	8,256
August 31, 1920—200% stock dividend paid in "B" on "A" and "B" holdings		16,512
Total	16,828	33,656
April 22, 1922—Sale		58,424
April 26, 1922—Balance		2,750
December 4, 1922—33½% stock dividend paid in "B" on "A" and "B" holdings		55,674
Total	16,828	18,558
Sale (December 22, 1922)		6,509½
Balance	16,828	79,841½
February 16, 1927—25% stock dividend paid in "B" on "A" and "B" holdings		79,841
Total	16,828	19,960½
February 16, 1927, to December 21, 1927—Sales	16,828	4,207
Balance	16,828	104,008½
January 3, 1929—Sale	0	16,000½
Balance		88,008
February 11, 1929—2½ new for 1 old		5,000
June 12, 1929—Delivered to you		83,008
April 7, 1934—Transferred to you from the trust		207,520
		3,977
		203,543

COST OF R. J. REYNOLDS TOBACCO CO. "B" BASED ON VALUE AT DATE OF DEATH

Acquired or sold	"A" shares	Value	"B" shares	Value
Dec. 30, 1918—From estate	4,207	\$1,051,750.00	2,000	\$410,000.00
Nov. 21, 1919—50% stock right payable in 7% preferred. Cost apportioned to rights:				
"A" .007212%		7,585.22		
"B" .008102%				3,324.28
Adjusted cost of shares	4,207	1,044,164.78	2,000	403,675.72
Dec. 6, 1920—From estate			64	13,120.00
Total	4,207	1,044,164.78	2,064	416,795.72

COST OF R. J. REYNOLDS TOBACCO CO. "B" BASED ON VALUE AT DATE OF DEATH—Continued

Acquired or sold	"A" shares	Value	"B" shares	Value
Aug. 31, 1920—4 shares of new for 1 old	16,828	\$1,044,164.78	8,256	\$419,795.72
19 Aug. 13, 1920—200% stock dividend paid in "B" on "A" and "B" holdings—Common "B" acquired on "A," cost apportioned to "B," .568966% (.568966% × \$1,044,064.78)		(593,994.26)	33,656	593,994.26
Cost	16,828	450,170.52	58,424	1,013,789.98
April 22, 1922—Sale			2,750	47,718.77
Balance	16,828	\$450,170.52	55,674	\$966,071.21
Dec. 4, 1922—33 1/4% stock dividend paid in "B" on "A" and "B" holdings			18,558	0
"B" stock acquired on "A," cost apportioned to "B," .187562% (\$450,170.52 × .187562%)		(84,434.88)	5,009 1/4	84,434.88
Balance	16,828	365,735.64	79,841 1/4	1,050,506.09
Dec. 22, 1922—Sale			1/4	4.39
Balance	16,828	\$365,735.64	79,841	\$1,050,501.70
20 Feb. 16, 1927—25% stock dividend paid in "B" on "A" and "B" holdings			19,960 1/4	9
"B" stock acquired on "A," cost apportioned to "B," .17866% (\$365,735.64 × .17866%)		(65,343.43)	4,207	65,343.43
Adjusted cost	16,828	\$300,392.21	104,008 1/4	\$1,115,845.13
Feb. 16, 1927—Sales through Dec. 21, 1927			16,000 1/4	171,657.54
Balance	16,828	\$300,392.21	88,008	\$944,187.59
Dec. 21, 1927—Sale	16,828	300,392.21		
Balance			88,008	\$944,187.59
Jan. 31, 1929—Sale			5,000	53,642.15
Balance			83,008	\$890,545.44
Feb. 11, 1929—2 1/4 shares new for one old			207,320	\$890,545.44
June 12, 1929—Delivered to you			3,977	17,006.72
Balance distributed from the trust to you on April 4, 1937			208,543	\$873,478.66
Cost of one share based on above				\$4,291.37
June 18, 1934—Sold through R. J. Reynolds & Co. brokers, 1,000 at a cost of				\$4,291.37
Cost as reported on your return				41,250.00
Decrease in cost, additional income				\$36,958.63

21 Received from sale of above 1,000 shares..... \$45,808.00
 Cost computed as above..... 4,291.37

Profit..... \$41,516.63
 30% taxable..... \$12,454.99
 Profit reported..... 4,555.00

Increase (item 2 above)..... \$7,899.09

(3) You reported a loss of \$21,092.50 on the sale of bonds of the City of Philadelphia which had been received through the above-mentioned trust and which the revenue agent increased to a profit of \$103,905.64 by using the cost of the securities of the trust in 1932 instead of the value at the date of distribution to you on April 4, 1934. However, it appears that in the years 1929, 1929, 1930, and

1931 the Safe Deposit and Trust Co. as trustee of the R. J. Reynolds, Jr., Trust purchased bonds of the City of Philadelphia which they sold at a loss in the year 1932 and claimed the loss as a deduction on the return filed for the trust. Similar securities were immediately repurchased by the trust and the loss claimed on the sale was disallowed in the return of the trust for the year 1932 under the wash sale provisions of section 118 of the Revenue Act of 1932. An appeal was filed by the trust with the United States Board of Tax Appeals against the deficiency in tax resulting from the disallowance of the loss. This appeal has now been settled and in some instances the sales made by the trust were held to be wash sales and in other instances they were held not to be wash sales.

Exhibit A attached shows the computation of the profit and loss on these securities based on the final settlement of the appeal and instead of a loss of \$21,092.50 as computed by you and a gain of \$103,905.54 as computed by the revenue agent there is a profit of \$224.30.

Loss as reported	\$21,092.50
Gain as corrected	224.30
Increase in income	\$21,316.80

22

COMPUTATION OF TAX—1934

Net income adjusted	\$434,241.12
Less: Personal exemption and credit for dependent	2,900.00
Balance (surtax net income)	\$431,341.12
Less:	
Dividends	\$706,144.90
Earned income credit	300.00
	706,444.90
Subject to normal tax	None
Surtax on \$431,341.12 (amount in excess of \$4,000)	\$207,061.03
Correct income-tax liability	\$207,061.03
Income tax assessed:	
Original, account #200200	\$142,150.10
Additional, May 29, 1936, page 1, line 2, #5	29,219.11
April 2, 1937, page 1, line 1, #1	1,803.21
	173,172.42
Deficiency of income tax	\$33,878.61

Exhibit A

Mr. Richard J. Reynolds—1934.

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	
	Security	Rate	Due	Date of purchase	Cost to trust	Date of sale by trust	Sale price by trust	Date of repurchases by trust	Repurchase price by trust	Date of sale by R. J. Reynolds	Sale by R. J. Reynolds	Adjusted cost to R. J. Reynolds	Gain or loss		Net gain or loss	
\$30,000.00	City of Phila.	4 1/4	1976	Jan. 3, 1930	\$30,112.50	Aug. 31, 1932	\$25,097.36	Aug. 31, 1932	\$25,023.30	May 3, 1934	\$30,225.00	\$30,112.50				
30,000.00	do	4 1/4	1976									225.94	(\$113.44)	60%	(\$63.08)	
245,000.00	do	4	1981	Mar. 6, 1931	144,833.75	Oct. 21, 1932						144,833.75				
245,000.00	do	4 1/2	1976	Mar. 7, 1931	25,062.50							25,062.50				
80,000.00	do	4	1981	Mar. 10, 1931	124,687.50	Oct. 14, 1932	41,250.00	Oct. 21, 1932	212,456.00	May 3, 1934	246,837.50	124,687.50				
80,000.00	do	4	1980					Oct. 14, 1932	41,500.02	May 5, 1934	49,500.00	13,411.49	307,965.24	(11,637.74)	60%	(6,994.64)
55,000.00	do	4	1978	1928		Dec. 21, 1932	43,852.50					373,452.50				
45,000.00	do	4	1978			Dec. 27, 1932	9,610.00	Dec. 21, 1932	44,000.00	May 5, 1934	54,450.00	137.50				
12,000.00	do	4	1978	1928		Dec. 27, 1932		Dec. 27, 1932	9,670.00	May 5, 1934	11,890.00	60.00				
12,000.00	do	4	1978	1928		Dec. 21, 1932	18,000.00									
200,000.00	do	4	1981			Dec. 22, 1932	50,000.00	Dec. 21, 1932	161,000.00	May 5, 1934	198,000.00	1,000.00				
100,000.00	do	4	1978	1928		Dec. 22, 1932	50,000.00									
100,000.00	do	4	1981					Dec. 22, 1932	80,000.00	May 5, 1934	99,000.00	500.00	375,150.00	(11,820.00)	40%	(4,728.00)
55,000.00	do	4	1933					Dec. 13, 1932	46,406.25	May 5, 1934	54,450.00	No adjustment necessary	8,043.75	80%	8,435.00	
545,000.00	do	4	1933					Dec. 28, 1932	37,575.00	May 5, 1934	44,550.00		6,975.00	80%	5,580.00	
	Total														224.30	

Columns 1 to 10, inclusive, include the original purchase by the trust and the sale and repurchase of a similar security on which the loss was disallowed in the examination of the trust return for the year 1932.

Columns 11 to 16, inclusive, include the transactions after the stock was distributed by the trust company to R. J. Reynolds.

Column 13 is computed by adding the original cost to the trust (column 6) to the loss disallowed in the examination of the trust return for 1932 (column 10 minus column 8).

(*) The loss claimed on the original securities acquired by the trust and sold in 1932 was allowed in the final determination of the tax liability for the year 1932; therefore, the cost to R. J. Reynolds is the cost of the securities repurchased by the trust.

Exhibit B to petition

WILL OF R. J. REYNOLDS

In the name of God, Amen: I, Richard Joshua Reynolds, of Winston-Salem, North Carolina, being of sound mind and disposing memory, and realizing the uncertainty of life, do make, publish, and declare my last Will and Testament to be as follows:

* * * * *

ITEM FOURTH

All the rest, residue, and remainder of my estate of every kind, character, and description, real, personal, and mixed, and where-soever, situated, I direct shall be divided by my executor, said Safe Deposit & Trust Company, between and among my wife and children living at my death, or thereafter born, and the living issue of any deceased child, per stirpes; that is, one-third (1-3) thereof to my wife absolutely (except one-third (1-3) of my common capital stock in R. J. Reynolds Tobacco Company which is subject to the terms of trust later herein created), and two-thirds (2-3) thereof to my children and the living issue of any deceased child, per stirpes; to be equally divided among them, share and share alike (the living issue of any deceased child to take such child's part). But Subject to the Following Trust, namely: I give, devise, and bequeath my wife's one-third (1-3) share of my common capital stock in R. J. Reynolds Tobacco Company and my children's shares in my entire estate (except the gift in Item First to my oldest living child which shall not be subject to this trust and which shall be in addition to such child's equal share of the residue of my estate), to the Safe Deposit & Trust Company of Baltimore, Trustee, to hold, dispose of, and distribute upon the following terms and conditions, to wit:

(1) Said Trustee will collect the income from my wife's one-third of my common capital stock in R. J. Reynolds Tobacco Company and, as collected, pay the net proceeds thereof over to her during the existence, or running, of the trusts, or any of them, created for her benefit and the benefit of my children by this Item Fourth of my last Will and Testament. At the termination of said trusts, said Trustee will turn over said stock to her absolutely, and it will likewise turn over to her the proceeds of any sale of said stock that may be made, during her life, pursuant to the sale provisions of this Item of my Will.

(2) Should my wife die testate before the termination of said trusts, then her share of my said common stock in R. J. Reynolds Tobacco Company shall continue to be held on like terms by said

Trustee for the use and benefit of her devises by Will until the termination of said trusts when said stock shall be disposed of as she may by Will direct, except that the income from any part, or parts, thereof that she may give to our children, or the living children of any deceased child, shall become a part of the trust estate herein created for their benefit and to be held and disposed of by said Trustee in accordance with the terms of this trust.

25 (3) And should my wife die before the termination of said trusts, intestate, or without making a Will, then the one-third of my common stock in R. J. Reynolds Tobacco Company herein devised to her in trust shall also become a part of the trust estate herein created for the benefit of my children, and shall be held and disposed of by my said Trustee in accordance with the terms and provisions of this trust.

(4) Said Safe Deposit & Trust Company, Trustee, is also authorized and directed to collect, for their equal benefit, all the income arising from my children's shares of my estate, and, until they severally arrive at the age of twenty-one (21) years, to pay to my wife, out of their respective shares, so much of said income as she may deem necessary or requisite for the support, maintenance, and education of each (of) them. Should my wife die before any one of my children shall have arrived at twenty-one (21) years of age, then said Trustee is authorized and directed to use its own discretion as to the amount to be paid in the support, maintenance, and education of each of my said children until they respectively reach their majority.

(5) From and after each of my said children shall arrive at the age of twenty-one (21) years and until they respectively attain the age of twenty-eight (28) years, said Trustee is authorized and directed to pay to each of them out of his or her respective share of said income, the sum of Five Thousand Dollars (\$5,000) per annum, unless, in the opinion of my wife, that amount shall be inadequate to meet the annual requirements of any one or more of my said children. In that event, and at the written request of my said wife, said Trustee is authorized and directed to enlarge said annual payment of Five Thousand Dollars (\$5,000) by whatever amount my wife sees fit to designate, provided the total annual allowance does not exceed Fifty Thousand Dollars (\$50,000). Should my wife die while any of my children are between the ages of twenty-one (21) and twenty-eight (28) years, then, from and after her death, said Trustee will pay to each of my said children, out of his or her share of my estate, and provided he or she shall have arrived at the age of twenty-one (21) years, Fifty Thousand Dollars (\$50,000) per annum, and is directed to accumulate all the

balance of said income for his or her respective use and benefit until he or she shall respectively attain the age of twenty-eight (28) years, when each of them shall become entitled to and shall respectively receive from said Trustee his or her share of the corpus of my estate, together with the accumulated income aforesaid.

(6) To encourage habits of industry, thrift, and economy in my children, I hereby make the following provision for further payments to them after they reach the age of twenty-one (21) years, and before they attain the age of twenty-eight (28) years, to wit: I direct said Trustee, Safe Deposit & Trust Company, annually, upon any of my children presenting to it a statement showing to said Trustee's satisfaction that he or she has made

26 by individual effort, in any legitimate business or investment or has saved from money, stocks, or bonds owned by him or her, any money over and above all living expenses, to pay to such child, out of his or her share of my estate, if necessary to the full extent of such share, two dollars for every one dollar so made or saved. Payment will be made in cash; or, if the child entitled thereto so elects, in stocks or bonds at par, including stocks in R. J. Reynolds Tobacco Company (subject to sale restrictions as to last named stocks as shown in Item Fifth hereof). But, said Trustee is directed to exclude and eliminate from any annual statement submitted under this provision of my Will any money made in buying and selling stocks or commodities of any kind, on margin (commonly known as dealing in "futures"), or earnings or profits derived from speculation of that character. Any married daughter may avail herself of this provision of my Will and may, in filing annual statements as herein required and subject to the same restrictions, include therein like earnings and savings, over and above expenses, by her husband.

(7) Should any of my children die before he or she shall arrive at the age of twenty-eight (28) years, then the share of my estate which would have been payable to him or her, had he or she arrived at that age, shall be continued to be held by my said Trustee for the use and benefit of his or her devisees by Will until the time that such child would have arrived at the age of twenty-eight years, if he or she had lived, when the said trust shall cease and the estate shall then become payable to such devisees, the Trustee, however, paying in the meanwhile the income from said share to them; but should any of my children die before that time without having disposed of his or her share by Will but leaving issue him or her surviving, the share of said deceased child shall continue to be held by said Trustee for the use and benefit of his or her children living at his or her death, paying unto them or applying so much of the net income of the share of my child so dying as said Trustee may deem necessary for their support and

maintenance and accumulating the balance until the time my child so dieing would have arrived at the age of twenty-eight years, if he or she had lived, when the trust shall cease and the estate shall then become vested in his or her children then surviving; and, should any of my said children die without having made a testamentary disposition of his or her share of my said estate and without issue living at the termination of said trust, then his or her share shall be held on like trusts for my surviving children and the then living issue of my deceased children per stirpes; and, should all of my children and their issue die before the termination of the trusts, then, in that event, one-half of the trust estate in value at that time, principal and income, shall go to and belong to my said wife, and the other half to my brothers and sisters then living and the descendants then living of any of my deceased brothers and sisters, per stirpes.

27 (8) Said Trustee is hereby authorized, with the assent of my wife, if she is living, and, after her death, in its own discretion, to sell any part of my estate, real or personal, and it is empowered to make all necessary transfers and conveyances, at any time it may be to her best interest and to the best interest of my children to do so; but my common capital stock in R. J. Reynolds Tobacco Company shall in no case be sold per share during the existence of any of the trusts herein created for the benefit of my wife and children at a price less than that which will represent a 10 per cent investment based on the average net profits of R. J. Reynolds Tobacco Company for the three fiscal years next preceding the date of sale as will appear from the books of the Company at the close of business for these years, and all proceeds from any and all sales, or any part of my estate, real or personal, as well as all earnings from my estate, shall only be invested in bonds of the United States, of the States of the Union, of the various municipalities thereof, separately or collectively, or in such proportion of any new issue, or issues, of stocks or bonds, of R. J. Reynolds Tobacco Company, as my Trustee's holdings therein may entitle it to take, under any offer to stockholders thereof, and, at the termination of the trusts, or any of them, my Trustee is hereby authorized to divide my estate in kind so far as the same may, in its judgment, be capable of division, and to sell any portion of said trust estate for the purpose of division, if it deems the same necessary, and in every case of sale to execute to the purchasers good and sufficient deeds and transfers without obligation to them to see the application of the purchase money.

ITEM FIFTH

It is my will and desire that all gifts and bequests of my common capital stock in R. J. Reynolds Tobacco Company, made in

this my last Will and Testament, are upon condition that such stock shall not be sold by anyone who shall receive it, during the life of any of the trusts herein created for the benefit of my wife and children, at a price less than that which will represent a 10 per cent investment, based on the average net profits of R. J. Reynolds Tobacco Company for the three fiscal years next preceding the date of sale, as may appear from the books of the Company at the close of business for these years.

* * * *

ITEM SEVENTH

I hereby nominate, constitute, and appoint my wife, Katherine Smith Reynolds, Executrix, hereunder of that portion of my estate which may be situate in North Carolina at the time of my death, and I direct that she shall be exempt from the necessity of giving bond as such and that she be not required to file in the

28 Clerk's Office any inventory or account, but in lieu thereof file with the Safe Deposit & Trust Company an inventory and account, under oath, of the amount of property received by her, and of her disbursements, including distributions made by her of my estate there situate, furnishing therewith, if required, proper vouchers covering all payments.

As soon after my death as convenient, I direct my said Executrix to pass over, transfer and deliver any of my estate located in the State of North Carolina to those who are entitled to the same under the provisions of this Will, turning over to said Safe Deposit & Trust Company of Baltimore, Trustee, the portion of my estate for the benefit of my said children.

I hereby nominate, constitute and appoint the Safe Deposit & Trust Company of Baltimore Executor hereunder of all my estate outside of the State of North Carolina, and I direct it to take into custody all of my said estate (except that located in the State of North Carolina) and to make distribution thereof to the devisees hereunder direct according to the provisions of this Will, and confer upon my said Executrix and Executor respectively full power and authority to do and perform all acts necessary to enable them to settle my estate and make effective and carry out the provisions of this Will.

ITEM EIGHTH

I hereby provide that all payments to be made hereunder to my beneficiaries shall be into their own hands and not into the hands of others, whether claiming by their authority or otherwise.

* * * *

ITEM ELEVENTH

I hereby direct, authorize and empower my wife, Katherine S. Reynolds, and my brother, William N. Reynolds, or the survivor of them, from time to time to appoint, or substitute, a new Trustee or Trustees of this my last Will and Testament, if my Trustee herein appointed, or if its successor or successors, shall refuse to serve, cease to exist, become incapacitated, or resign, or, if, in the judgment of my wife and brother, or in the judgment of the survivor of them, it shall be for the best interest of my estate to substitute and appoint another or other Trustees in the place of the then Trustee, or Trustees. The appointment or substitution above provided for shall be made by a written instrument, under seal, duly acknowledged and recorded and filed with the proper keeper of records where required to be filed. Thereupon, and so often as any new Trustee, or Trustees, shall be substituted or appointed, as aforesaid, all the property, real, personal and mixed of every nature and kind whatsoever and wheresoever situated, which shall be held upon the trusts herein created, shall be conveyed, assigned and transferred, respectively, in such manner that the same shall become legally and effectually vested in the new Trustee or Trustees, who shall thenceforth be competent to act in the execution of the trusts herein created, as fully and effectually with all the same powers and authorities, and subject to all the conditions and restrictions, to all intents and purposes whatsoever, as if originally appointed herein.

ITEM TWELFTH

I hereby expressly revoke all Wills heretofore at any time made by me.

In witness whereof, I have hereunto subscribed my name and affixed my seal this 25th day of July, 1917.

R. J. REYNOLDS. [SEAL.]

Signed, Sealed, Published, and Declared by Richard Joshua Reynolds, the above named Testator, as and for his last Will and Testament in the presence of us, who, at his request, in his presence, and in the presence of each other, have hereunto subscribed our names as attesting witnesses thereto.

D. RICH.
GEO. W. ORR.
H. H. SHELTON.

Answer

Filed July 26, 1938

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, denies and alleges as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged in paragraph 4 of the petition.

5. (a) Admits the allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that R. J. Reynolds (senior) died, leaving a last will and testament which was duly admitted to probate and administered in accordance with its terms. Denies all other material allegations of fact contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits that in his said last will and testament the decedent devised and bequeathed a portion of his estate to the Safe Deposit & Trust Company of Baltimore, Maryland, as Trustee, for the benefit of the decedent's children. Denies all other material allegations of fact contained in subparagraph (c) of paragraph 5 of the petition.

(d) Denies the material allegations of fact contained in subparagraph (d) of paragraph 5 of the petition herein.

(e), (f), and (g) Denies the material allegations of fact contained in subparagraphs (e), (f), and (g) of paragraph 5 of the petition herein.

(h) Admits that the petitioner attained the age of twenty-eight years on April 4, 1934. Denies all other material allegations of fact contained in subparagraph (h) of paragraph 5 of the petition herein.

(i), (j), (k), (l), (m), and (n) Denies the material allegations of fact contained in subparagraphs (i), (j), (k), (l), (m), and (n) of paragraph 5 of the petition herein.

(o) Admits the petitioner attained the age of twenty-eight years on April 4, 1934. Denies all other material allegations of fact contained in subparagraph (o) of paragraph 5 of the petition herein.

(p) Admits that in accordance with the authority and direction contained in the trust instrument the trustees transferred, delivered and distributed to petitioner a certain portion of the assets comprising the corpus of the trust, among which were certain stocks and securities. Denies all other material allegations of fact contained in subparagraph (p) of paragraph 5 of the petition herein.

(q) Admits that in the said year 1934 the petitioner sold certain of the said stocks and securities. Denies all other material allegations of fact contained in subparagraph (p) of paragraph 5 of the petition herein.

(r) Admits that in his income tax return for the year 1934, petitioner reported the said sales made by him and in computing the gains and losses arising upon said sales the petitioner used as the basis or cost thereof the fair market value of said property on April 4, 1934, and reported his taxable income accordingly. Denies all other material allegations of fact contained in subparagraph (r) of paragraph 5 of the petition herein.

(s) Admits that the respondent has determined that the basis to be used by petitioner in computing his gains and losses on said sales is as set forth in respondent's notice of deficiency attached to the petition herein as Exhibit A. Denies all other material allegations of fact contained in subparagraph (s) of paragraph 5 of the petition herein.

(t), (u), and (v). Denies the material allegations of fact contained in subparagraphs (t), (u), and (v) of paragraph 5 of the petition herein.

Denies generally and specifically each and every allegation contained in the petition not hereinabove admitted, qualified, or denied.

Wherefore, it is prayed that the Board redetermine the correct amount of the deficiency involved in this proceeding to be equal to the amount designated by the Commissioner, viz., \$33,873.51.

J. P. WENCHEL,

G. W. K.

J. P. Wenchel,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

F. R. SHEARER,

D. A. TAYLOR,

Special Attorneys,

Bureau of Internal Revenue.

DAT/BF. 7-22-38.

[Title omitted.]

Stipulation of facts

Filed April 12, 1939

It is hereby stipulated by and between the above named petitioner and the Commissioner of Internal Revenue, through their respective attorneys, that the following facts are true and that the Board may incorporate the same into its findings of fact, subject to the right of either party to introduce additional evidence not inconsistent herewith.

1. The petitioner is a citizen of the State of North Carolina and resides in the County of Forsyth within said State. Petitioner is the son of R. J. Reynolds, deceased, and was born in Forsyth County, North Carolina, on April 4, 1906.

2. R. J. Reynolds (senior), father of the petitioner, died testate on July 19, 1918, leaving four infant children surviving him. Petitioner was the oldest of said four children.

3. R. J. Reynolds (senior) died leaving a last will and testament, copy of which is contained in the volume filed with this stipulation as Exhibit A hereof, and by such reference made a part of this stipulation.

4. Safe Deposit & Trust Company, a banking and trust corporation of the City of Baltimore, was designated by the decedent, R. J. Reynolds (senior) as the Trustee of the Trust
35 created by said will (in "ITEM FOURTH" thereof) for the benefit of the instant petitioner and others; and on the 3rd day of August, 1926, the said Safe Deposit & Trust Company as Trustee received and took over the assets of the Trust, from the Estate of R. J. Reynolds, deceased, in accordance with the terms of the said last will and testament of said R. J. Reynolds, deceased; and thereafter as such Trustee administered the Trust and the assets thereof in accordance with the terms of said Trust; and continues so to administer the said Trust to the present date for the benefit of certain of the beneficiaries of said Trust other than the instant petitioner.

5. Petitioner attained the age of twenty-eight (28) years on April 4, 1934, and on said date became entitled to a portion of the trust corpus together with certain accumulated income arising from the Trust, as provided in the said last will and testament of said R. J. Reynolds, deceased.

6. On the said date (April 4, 1934) the Trustee, Safe Deposit & Trust Company, acting in accordance with the authority and directions of the trust instrument, transferred, delivered, and dis-

tributed to petitioner the portion of the assets of the Trust to which petitioner became entitled on that date, as aforesaid, and on said date the petitioner acquired the said portion of the assets of the Trust to which he became entitled on that date.

7. Among the assets to which petitioner became entitled on April 4, 1934, and on which said date said assets were distributed to, and acquired by, petitioner, were certain securities which petitioner sold within the year 1934, on a date or dates subsequent to April 4, 1934. In his income tax return for the year 1934, the petitioner computed and reported his profits and losses (arising upon such said sales) by comparing the sales price received by him with the fair market value of the said securities (so sold by petitioner as aforesaid) on the date the said securities were acquired by petitioner upon their distribution to him by the Trustee, as aforesaid, to-wit, April 4, 1934.

8. Included in the securities so distributed to petitioner and acquired by him on April 4, 1934, as aforesaid, were certain bonds which had been purchased by the Trustee (Safe Deposit & Trust Co.) at various dates subsequent to the death of R. J. Reynolds, deceased, but prior to April 4, 1934. It is agreed that if the basic date for computing the capital gains realized, or capital losses sustained, is April 4, 1934, then there is no deficiency arising upon the item numbered (1) on page 2 of the statutory deficiency noted; but that if the basic date for computing the capital gains realized, or capital losses sustained, is as determined by the Commissioner in his statutory notice of deficiency, then the taxable income of petitioner under this item should be increased by the amount of \$31,811.84.

9. Included in the securities so distributed to petitioner and acquired by him on April 4, 1934, as set out above herein, were one thousand (1,000) shares of R. J. Reynolds Tobacco Co. Class "B" common stock. The said shares constituted a portion of the shares of such said stock owned by decedent, R. J. Reynolds, at the date of his death. It is agreed that if the basic date for computing the capital gains realized, or capital losses sustained, is April 4, 1934, then there is no deficiency arising upon the item numbered (2) on page 2 of the statutory deficiency notice; but that if the basic date for computing the capital gains realized, or capital losses sustained, is as determined by the Commissioner in his statutory notice of deficiency, then the taxable income of petitioner under this item should be increased by the amount of \$7,899.09.

10. Included in the securities so distributed to petitioner and acquired by him on April 4, 1934, as set out above herein, were certain bonds which had been purchased by the Trustee at various dates subsequent to the death of R. J. Reynolds, deceased, but

prior to April 4, 1934. It is agreed that if the basic date for computing the capital gains realized, or capital losses sustained, is April 4, 1934, then there is no deficiency arising upon the item numbered (3) on page 2 of the statutory deficiency notice; but that if the basic date for computing the capital gains realized, or capital losses sustained, is as determined by the Commissioner in his statutory notice of deficiency, then the taxable income of petitioner under this item should be increased by the amount of \$21,316.90.

11. By reason of the action taken by the Commissioner, as set out in the statutory deficiency notice in this cause, the Commissioner increased petitioner's net taxable income by the amount of \$61,027.63 and computed thereon a deficiency in income tax. The said action of the Commissioner in respect of the said amount of \$61,027.63 constitutes the sole controversy between the parties in this cause. It is agreed that if the basic date for determining capital gains or losses is April 4, 1934, as contended by the
38 petitioner, then there is no deficiency whatsoever in this cause; but that if the basic date for computing the capital gains or losses is as determined by the Commissioner in his statutory deficiency notice, then the deficiency of \$33,878.61, as computed by the Commissioner in his statutory deficiency notice, is correct.

12. One son of the testator (to wit, Zachary Smith Reynolds) died on July 6, 1932. The said Zachary Smith Reynolds was the brother of petitioner and under the Trust created by said R. J. Reynolds, deceased, in his last will and testament (referred to hereinabove) the said Zachary Smith Reynolds was a beneficiary under the same terms and provisions of the said Trust as those relating to the petitioner herein.

13. Filed with this stipulation, and identified by the signatures of counsel for the parties are two duplicate printed volumes entitled:

No. 760. Eleventh District. Supreme Court of North Carolina. Spring Term 1935. Anne Cannon Reynolds, et al. against Zachary Smith Reynolds, et al. (filed with this stipulation as Exhibit A hereof) and two duplicate printed volumes entitled: Part of Record and Proceeding in the Supreme Court of Forsyth County and in the Supreme Court of North Carolina In a Civil Action Entitled: Anne Cannon Reynolds, et al. vs. Zachary Smith Reynolds, et al. (filed with this stipulation as Exhibit B hereof).

39 It is stipulated and agreed that said copies are true and full copies of the proceedings in said case, and that the several wills, deeds of trust, grants and letters and other papers and documents of which copies appear in the said printed volumes (exhibits A and B filed herewith) are true copies; and that, in so far as the said record or proceedings or any of the said papers and documents may be admissible or relevant in the trial of the instant

proceeding, it shall not be necessary to prove the same by certified copies or otherwise; but that the copies of said record and proceeding and all the papers and documents appearing therein (Exhibits A and B filed herewith) shall be deemed sufficient proof thereof.

(s) J. G. KORNER, Jr.,

J. G. Korner, Jr.,

(s) H. G. HUDSON,

H. G. Hudson,

(s) STRATTON COYNER,

Stratton Coyner,

Transportation Building, Washington, D. C.,

Counsel for petitioner.

(s) J. P. WENCHEL,

J. P. Wenchel,

Counsel for respondent.

FEBRUARY 28, 1939.

40

Before United States Board of Tax Appeals

[Title omitted.]

[File endorsement omitted.]

Submission under rule 30

Filed April 12, 1939

J. G. Koerner, Jr., Esq., for the petitioner

R. H. Transue, Esq., for the respondent.

The above case is hereby submitted under Rule 30 of the Board of Tax Appeals on the filing herewith of a Stipulation of Facts, accompanied by certain exhibits referred to in the stipulation.

J. G. KORNER,

Attorney for the Petitioner.

J. P. WENCHEL,

Attorney for the Respondent.

By R. H. TRANSUE.

41

Before United States Board of Tax Appeals

RICHARD J. REYNOLDS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 94108. Promulgated January 10, 1940

Under a will of 1918 providing that the testator's children should receive shares of trust corpus upon reaching a certain age, one of

the children upon his birthday in 1934 received securities from the trustee and sold them in that year. Held, the basis for gain or loss, Revenue Act of 1934, section 113 (a) (5), was the fair market value on the date of the death of the testator.

J. G. Korner, Jr., Esq., for the petitioner.

Rollin H. Transue, Esq., for the respondent.

Opinion

STERNHAGEN: The Commissioner determined a deficiency of \$33,878.61 in petitioner's income tax for 1934, resulting from the use of a lower basis than that used by petitioner in computing the capital gain derived from the sale of securities. The case is submitted under Rule 30 upon a written stipulation.

Petitioner's father died July 19, 1918, and by his will two-thirds of the residue of his estate was left in trust. The trustee was directed to pay the widow enough of the income to maintain the children until each became twenty-one; then to pay each child \$5,000 or more a year until he became twenty-eight, "when each of them shall become entitled to and shall respectively receive * * * a share of the corpus, together with the accumulated income." Provision was made for distribution in case a child should die before becoming twenty-eight.

The trustee received the trust assets from the estate in 1926 and distributed the proper share of them, including securities, to petitioner on April 4, 1934, when he became twenty-eight. Some of the securities so distributed had been received by the trustee from the decedent's estate and others had been acquired by the trustee in intermediate transactions. Petitioner sold some of the securities during the year at a profit. In computing gain, he used as basis the value on April 4, 1934, when he received them from the

42 trustee. The Commissioner, however, used as basis the lower value of the securities at the time of the father's death in the case of those then held by the father, and their cost to the trustee in the case of those which it had acquired thereafter. The decision turns upon the Revenue Act of 1934, section 113 (a) (5): "If the property was acquired by bequest * * * the basis should be the fair market value of such property at the time of such acquisition."

The petitioner did no doubt receive the very securities only when they were distributed to him in 1934. The question is whether time of such receipt is what the statute means as the "time of acquisition." That question must be decided primarily with regard for the fulfillment of the purpose of the statute and not only with regard for the generally accepted meaning of the particular phrase. This was the reasoning of *Brewster v. Gage*, 280 U. S. 327. In point of fact the direct legatee in that case did not receive the

bequeathed property before the distribution of the decedent's estate, but the Court held that nevertheless the statutory time of acquisition was the date of decedent's death.

The intendment of the statute requires the same construction here. The intervention of the fiduciary administering the trust involves quite the same difficulties under this very statutory subsection as did the intervention of the fiduciary administering the decedent's estate. As to both, the dominant legislative purpose was to prescribe a basis which would result in taxing the increment in value of the property upon the occasion of its realization. It is plain that such purpose which was promoted only by judicial construction in *Brewster v. Gage*, supra, as to bequests delayed by administration and distribution of the estate, would be defeated as to bequests delayed by intervening trusts if the same reasoning were not applied. *Elizabeth G. Augustus*, 40 B. T. A. — (Dec. 20, 1939).

Petitioner argues that the phrase "time of acquisition" must be construed with regard to whether the interest bestowed upon him by the will was a vested or contingent interest; that if a contingent interest it may not be regarded as acquisition of the property, and that by North Carolina law (*Reynolds v. Reynolds*, 208 N. C. 578; 182 S. E. 341) his interest was a contingent interest until he received the securities by distribution. The argument must be rejected because the proper application of the statute is not dependent upon whether the interest created in petitioner by the trust was but a contingent interest. *Elizabeth G. Augustus*, supra; *Richard Archbold et al.*, 40 B. T. A. — (Dec. 22, 1939). Even if it was contingent, the intendment of the statute was that the securities actually received when distributed are to be regarded as putatively acquired

43 by the beneficiary when the testator died, if their identity has been preserved, or when the trustee acquired them by purchase or exchange if the original securities have been disposed of in such an intermediate transaction. The basis of the beneficiary is, therefore, the value at the date of the testator's death as to the securities left by the testator and received by the petitioner, and the basis of the trustee as to the securities acquired by the trustee by purchase or exchange.

Reviewed by the Board.

Decision will be entered for the respondent.

VAN FOSSAN dissents.

Concurring opinion

DISNEY, concurring: I concur in the result. I think that the estate created by the testator for his children was vested, and that opinion should be placed upon that ground. The will recites,

under "Item Fourth," that the residue of the testator's estate should be divided one-third to his wife "and two-thirds ($\frac{2}{3}$) thereof to my children and the living issue of any deceased child, per stirpes, to be equally divided among them, share and share alike." It is true that it is subject to a trust, but the statement of the trust itself refers to "my children's shares in my entire estate"; also refers to "the trust estate herein created for their benefit"; and "the trust estate herein created for the benefit of my children." Later, we find the expression, referring to the children, "out of their respective shares"; also "said trustee will pay to each of my said children, out of his or her share of my estate, and provided he or she shall have arrived at the age of twenty-one (21) years, Fifty Thousand Dollars (\$50,000) per annum." Particularly, however, and immediately following the language last quoted, I note the language "and is directed to accumulate all the balance of said income for his or her respective use and benefit until he or she shall respectively attain the age of twenty-eight (28) years, when each of them shall become entitled to and shall respectively receive from said Trustee his or her share of the corpus of my estate, together with the accumulated income aforesaid." In my opinion, this language, taken together with the other expressions above quoted, must be construed as a statement as to when the devise, vested at the time of death, should be payable. Such an estate is vested and not contingent. Inasmuch as this matter arose in the State of North Carolina and inasmuch as the majority opinion recites petitioner as relying in part upon the fact of a decision by the Supreme Court of that state in Reynolds v. Reynolds, 208 N. C. 578; 182 S. E. 341, as a determinative ruling, I note the opinion of that court in Hooker v. Bryan, 140 N. C. 402, 53 S. E. 130, holding as follows:

"Testatrix devised the residue of her real estate to H. "upon his becoming 21 years of age," and lent the same to her sister
44 until such event. She also lent to such sister her personal property, in trust for H. until he became 21 years of age. Held, that the clause "upon his becoming 21 years of age" should be construed merely to postpone the enjoyment of the estate, which was a remainder vesting in H. from the date of testatrix's death."

In Vanderwarker's Estate, 81 Minn. 197, 83 N. W. 538, a legacy was provided in terms not dissimilar to those involved herein: Five thousand dollars was given, devised and bequeathed to executors in trust, for a grandchild of testator, to be loaned, the interest added to principal until the granddaughter arrived at the age of 21 years, at which time all interest should be paid to her, and the interest thereafter likewise paid to her "until she arrives at the age of thirty years, when I direct my said executors to pay to my said granddaughter * * * the said five thousand

dollars." Held, the granddaughter had a vested estate, which descended upon her death before receipt, to her heirs.

45 Before United States Board of Tax Appeals, Washington

Docket No. 94108

RICHARD J. REYNOLDS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

In accordance with the Board's report, promulgated January 10, 1940, it is

Ordered and decided that there is a deficiency of \$33,878.61 in income tax for 1934.

Enter:

Entered Jan. 11, 1940.

[SEAL]

(S) J. M. STERNHAGEN, Member.

46 In United States Circuit Court of Appeals for the Fourth Circuit

Petition for review

Filed March 25, 1940

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Fourth Circuit:

Richard J. Reynolds, the petitioner, in support of this, his petition, filed pursuant to the provisions of sections 1001, 1002, and 1003 of the Act of Congress, entitled the Revenue Act of 1926 (as amended by section 1101 of the Revenue Act of 1932, and section 519 of the Revenue Act of 1934), for the review of the decision of the Board of Tax Appeals rendered the 11th day of January, 1940, determining and ordering a deficiency in income tax of petitioner, in the amount of \$33,878.61, shows to the Court as follows:

I

On March 11, 1938, the Commissioner mailed to petitioner a Notice of Deficiency, advising petitioner that he had determined a deficiency in income tax for the calendar year 1934, in the amount of \$33,878.61.

In his said Notice of Deficiency the Commissioner advised petitioner that the proposed additional income tax of \$33,878.61 resulted from the Commissioner's action in adding \$61,027.63 to petitioner's net income, which said amount the Commissioner claimed represented a capital net gain realized by petitioner on the sale in 1934 by petitioner of certain securities. The said securities had been distributed to, and acquired by, the petitioner on April 4, 1934, on which said date petitioner became entitled to receive, and did receive, said securities from Safe Deposit and Trust Company, Trustee of a certain testamentary trust created by the will of petitioner's father who died testate on July 19, 1918.

On June 3, 1938, petitioner filed an appeal from said Deficiency Notice, in the Board of Tax Appeals.

On July 26, 1938, respondent filed his answer in the Board.

The cause came on for hearing in the Board on April 12, 1939, and was at that time submitted by the parties upon the pleadings and a written stipulation accompanied by certain exhibits, which was duly filed at that time.

Upon the record as submitted, the sole issue for determination by the Board was: Whether in 1934 petitioner realized a taxable profit of \$61,027.63 on his sale in 1934 of certain securities acquired by him earlier in 1934 (to-wit, on April 4, 1934) from Safe Deposit and Trust Company, under the facts and circumstances disclosed by the record.

Thereafter, on January 10, 1940, the Board promulgated findings of fact and an opinion in which it was held and decided that petitioner had realized a taxable profit in 1934 of \$61,027.63, by reason of the sale of said securities.

On January 11, 1940, the Board entered a decision, ordering that there is a deficiency in income tax in the amount of \$33,878.61, for the year 1934.

48

II

The nature of the controversy, is as follows: R. J. Reynolds (Senior), father of the petitioner, died testate on July 19, 1918, leaving four infant children surviving him. Petitioner was the oldest of said children. In his last will and testament Mr. Reynolds created identical testamentary trusts for each of his four children. The salient portions of the will creating the trusts are as follows:

1. The Trustee was to apply such of the income as was deemed necessary for the support, maintenance and education of each child until such child became 21 years of age.

2. From the date each child became 21 years of age, and until he attained the age of 28 years, the Trustee was to pay such child an annual income of not less than \$5,000 and not more than \$50,000.

3. To accumulate all the balance of the trust income for the respective use of each child "until he or she shall respectively attain the age of twenty-eight (28) years, when each of them shall become entitled to and shall respectively receive from said Trustee his or her share of the corpus."

4. "Should any of my children die before he or she shall arrive at the age of twenty-eight (28) years, then the share of my estate which would have been payable to him or her, had he or she arrived at that age, shall be continued to be held by my said Trustee * * *"

5. In the event a child did not live to the age of 28, the Trustee was to continue to hold the trust for the benefit of a devisee of such child until the date such child would have reached 28, 49 if he had lived that long, at which time the trust should terminate and be payable to such devisee.

6. In the event a child did not live to the age of 28, and died intestate, leaving issue, the Trustee was to continue the trust for the benefit of such issue until the date that such child would have reached 28, if he had lived that long, at which time "the trust shall cease and the estate shall become vested" in such issue as may be living at such date.

7. The will provided that all payments to be made to the beneficiaries "shall be into their own hands and not into the hands of others, whether claiming by their authority or otherwise."

The will appointed Safe Deposit and Trust Company of Baltimore the Trustee of the trust. Said Trustee received and took over the assets of the trust from the estate of the decedent and thereafter administered the trust and the assets thereof in accordance with the terms of the said trust.

Petitioner was the oldest of the four children of the decedent and was 12 years of age when his father died. Petitioner attained the age of 28 on April 4, 1934, and on said date his interest in the trust was vested and he became entitled to a portion of the trust corpus, together with certain accumulated income arising from the trust, as provided in the last will and testament of his father. On the said date (April 4, 1934) the Trustee acting in accordance with the authority and directions of the trust instrument, terminated, delivered and distributed to petitioner the portion of the assets of the trust which vested in petitioner on that day and to which he became entitled on that day; and on said day the petitioner acquired the said portion of the assets of the trust to which he became entitled on that date.

50 Included in the assets so distributed to petitioner and acquired by him on April 4, 1934, were certain bonds which had been purchased by the Trustee at various dates subsequent to the death of R. J. Reynolds, deceased, but prior to April 4, 1934.

Included in the securities so distributed to petitioner and acquired by him on April 4, 1934, were 1,000 shares of R. J. Reynolds Tobacco Co. Class "B" common stock. These said shares constituted a portion of the shares of such said stock owned by the decedent R. J. Reynolds at the time of his death.

Among the assets to which petitioner became entitled on April 4, 1934, and on which said date said assets were distributed to, and acquired by, petitioner, were certain securities which petitioner sold within the year 1934, on a date or dates subsequent to April 4, 1934. In his income tax return for the year 1934, the petitioner computed and reported his profits and losses (arising upon such said sales) by comparing the sales price received by him with the fair market value of said securities (so sold by petitioner as aforesaid) on the date the said securities were acquired by petitioner upon their distribution to him by the Trustee as aforesaid, to wit, April 4, 1934.

The Commissioner disallowed the action of the petitioner in computing his profits and losses as above set out; and recomputed the profits and losses of the petitioner on the sale of said securities, (1) by comparing the sales price of the stock with the value of that said stock on the date of the death of R. J. Reynolds, deceased, and (2) by comparing the sales price of the bonds with the price which the Trustee had paid for these bonds when they were purchased by the Trustee. By this action the Commissioner reduced the "basis" for computing petitioner's gain or loss and thereby increased the profits realized by petitioner on the sale of said stock and
51 bonds by the amount of \$61,027.63; which said amount the Commissioner added to petitioner's net income.

The tax result of the addition of \$61,027.63 to petitioner's net income is a deficiency in the amount of \$33,878.61, as computed by the Commissioner in his statutory deficiency notice.

The addition by the Commissioner of \$61,027.63 to petitioner's net income constitutes the sole issue in this cause.

The petitioner resisted the said action and determination of the Commissioner and insisted that until April 4, 1934 (the date on which petitioner became 28 years of age), the petitioner did not acquire a substantial ownership of the said securities and that no part of the said trust estate vested in the petitioner until he arrived at the age of 28 years; that until petitioner arrived at the age of 28 years the only interest which he had in the trust estate was to receive such payments from the income thereof if, as and when, payable to him under the terms of the will; that petitioner's interest was merely expectant and contingent; and that unless and until he arrived at the age of 28 years "no part of the trust estate would have vested in him" and that, therefore, petitioner did not "ac-

quire" the property or any substantial ownership or estate therein until April 4, 1934.

For the foregoing reasons the petitioner contended that he acquired the property on April 4, 1934, within the meaning of section 113 (a) (5) of the Revenue Act of 1934, which says:

"If the property was acquired by bequest, devise or inheritance * * * the basis shall be the fair market value of such property at the time of such acquisition * * *."

Petitioner therefore contended that the proper basis for computing his gain or loss on the sale of the said securities was
52 the fair market value of the said securities on April 4, 1934, the date on which they were acquired by him.

Petitioner contended and argued that the nature of his interest in the trust res had been fixed and determined by a decision of the Supreme Court of North Carolina in a suit involving the instant trust, wherein the Supreme Court (affirming the lower Court), held that the will of R. J. Reynolds, deceased, did not bequeath or devise to the petitioner any vested interest or share in the trust estate (or any part thereof) created and established by said will; that no part of the trust estate would have vested in petitioner unless and until he arrived at the age of 28 years; that until petitioner arrived at the said age of 28 years the only interest which he had in the trust estate was to receive certain income payments therefrom, if, as, and when payable to him, under the terms of the will; and that a beneficiary of the trust dying before arriving at the age of 28 years could not transfer any part of the trust corpus to anyone by reason of his death.

The Commissioner contended that under the law governing wills and the descent and distribution of the property of the decedent, all titles to property acquired by bequest, devise, or inheritance relates back to the date of the decedent's death, even though the interest of him who takes the title was, at the date of the death of the decedent, legal, equitable, vested, contingent, general, residual, conditional, executory, or otherwise; and that even though, up to and until April 4, 1934, the petitioner's rights and interests in the trust corpus were contingent, conditional, expectant, or otherwise,
53 nevertheless his "acquisition" of the property obtained and became fixed; and that his "acquisition" of the property was complete, regardless of the nature, quality, or extent of his right or interest therein.

III

In its decision the Board rendered an opinion in which the stipulated facts are incorporated by reference.

In its opinion the Board rejected petitioner's contention that the phrase "time of acquisition" must be construed with regard to

the nature of the interest acquired, and that if it is merely expectant, contingent, or conditional, it may not be regarded as an acquisition of the property under North Carolina law. The Board held, on the contrary, that the application of the statute does not depend on the nature, quantity, or quality of the interest of the beneficiary; and that even though, prior to petitioner's 28th birthday (when the property was actually distributed to and actually received by the petitioner) his interest in the property was merely contingent, conditional, or expectant, nevertheless the property is to be regarded as having been acquired by him when his father died 16 years before; and that, in the matter of the bonds, the petitioner will be regarded as having "acquired" those bonds at the time the Trustee purchased them.

The Board found that petitioner actually received the property only when it was distributed to him on April 4, 1934, but held that "time of acquisition" means the date of decedent's death, and stated that such was the reasoning of *Brewster v. Gage*, 280 U. S. 327; whereas such was not the reasoning of *Brewster v. Gage*, because in that case it was conceded that the beneficiary's interest vested at the date of decedent's death, and the Supreme Court held that the property was "acquired" by the beneficiary at the time his interest became vested; and that case did not hold that a contingent or conditional right in property, or a property right which was not vested, was one which was "acquired" at the date of testator's death. The decision of the Board is not supported by *Brewster v. Gage*, but is in conflict with it. The decision of the Board is also in conflict with the long-continued Departmental construction which has received legislative sanction and approval.

IV

Petitioner being aggrieved by said opinion, decision, and order of the Board, and being an individual taxpayer residing in the State of North Carolina, and having filed his income-tax return for said year 1934 in the office of the Collector of Internal Revenue for the Collection District of North Carolina, desires a review thereof in accordance with the provisions of the Revenue Act of 1926 (as amended) and in accordance with other pertinent provisions of law, by the United States Circuit Court of Appeals for the Fourth Circuit, within which Circuit is located the residence of the petitioner and within which Circuit is located the office of the Collector of Internal Revenue to whom petitioner made his income-tax return for 1934.

V

Petitioner says that in the Decision, Opinion, and Order of the Board manifest error occurred and intervened to the prejudice of the petitioner, and petitioner assigns the following errors and each of them, which, he avers, occurred therein and upon which he relies to reverse said Decision and Order so entered by the Board in this cause, to wit:

55 1. The Board erred in concluding and deciding that petitioner "acquired" the said Reynolds common stock upon the date of the death of R. J. Reynolds, deceased.

2. The Board erred in concluding and deciding that petitioner "acquired" the said bonds upon the date or dates when said bonds were purchased by the Trustee.

3. The Board erred in concluding and deciding that the "acquisition" of said stock by petitioner related back to the death of R. J. Reynolds, deceased, even though the interest of petitioner in said stock was not vested in him until April 4, 1934, and even though prior to that date petitioner's interest was merely contingent and conditional.

4. The Board erred in concluding and deciding that the "acquisition" of said bonds by petitioner related back to the date or dates of their purchase by the Trustee, even though an interest in said bonds was not vested in him until April 4, 1934, and even though prior to that date petitioner's interest was merely contingent and conditional.

5. The Board erred in concluding that the decision in *Brewster v. Gage*, 280 U. S. 327, was to the effect that such "acquisition" relates back to the date of decedent's death when the interest of the beneficiary did not vest at date of decedent's death, whereas that case was specifically grounded on the fact that the interest of the beneficiary became vested at decedent's death and for that reason was acquired by the beneficiary at that date.

6. The Board erred in failing and refusing to decide that petitioner acquired the said securities on April 4, 1934, on which date his interest in them became vested.

56 7. The Board erred in failing and refusing to decide that petitioner's "basis" for computing gains and losses (on the sale of said securities) was the market value of said securities on April 4, 1934, on which date his interest in them became vested and on which date he acquired a substantial property interest in them.

8. The Board erred in deciding that petitioner's said "basis" as to the Reynolds' stock was the value of said stock on the date of decedent's death; and, as to the bonds, was the same as the Trustee's basis.

9. The Board erred in failing and refusing to decide for the petitioner.

10. The Board erred in deciding for the respondent.

11. The Board erred in adding to petitioner's net income the amount of \$61,027.63.

12. The Board erred in entering its decision and order of January 11, 1940, stating that there is a deficiency in income tax for the year 1934, of \$33,878.61.

13. The Board erred in that its Opinion and Decision are not supported by the evidence but are contrary to the evidence and contrary to law.

Wherefore, petitioner prays that the Circuit Court of Appeals for the Fourth Circuit may review the action, Decision, and Order of the Board of Tax Appeals in this case, and direct the entry of a decision by said Board in favor of the petitioner, determining that there is no deficiency in income tax for the year

1934, by reason of the sales of securities in 1934, here in question, which constitute the subject matter of this appeal; and

that the Clerk of said Board be directed to transmit and deliver to the Clerk of this Court, certified copies of all and every of the documents necessary and material to the presentation and consideration of the foregoing petition for review, as required by the rules of this Court, and by statutes made and provided; and for such other and further relief as may to this Court appear proper in the premises.

J. GILMER KORNER, Jr.,

404 Transportation Building, Washington, D. C.

Of Counsel:

H. G. HUDSON,

Wachovia Bank Building, Winston-Salem, N. C.

STRATTON COYNER,

Reynolds Building, Winston-Salem, N. C.

Duly sworn to by Richard J. Reynolds; jurat omitted in printing.

58 In United States Circuit Court of Appeals for the Fourth
Circuit

[Title omitted.]

[File endorsement omitted.]

To B. D. GAMBLE, Clerk, —

United States Board of Tax Appeals.

Præcipe for transcript of record

Filed March 26, 1940

To B. D. GAMBLE, Clerk,
United States Board of Tax Appeals.

SIR: It is requested that you prepare a transcript of the record in this cause, as required by law and the rules of the Board and the rules of the United States Circuit Court of Appeals for the Fourth Circuit, under the appeal heretofore perfected in the above-entitled cause, and include in said transcript the following documents:

1. The docket entries in this proceeding in the Board.
2. The pleadings in the Board, including
 - (a) the Petition.
 - (b) the Answer.
3. The Stipulation of Facts filed by the parties in the Board on April 12, 1939, together with, and including, "Exhibit A" and "Exhibit B," referred to and described in paragraph 13 of said stipulation, and filed with and made a part of said stipulation.
4. The "Submission under Rule 30" filed April 12, 1940.
5. Opinion of the Board, promulgated January 10, 1940.
6. Decision and Order of the Board entered January 11, 1940.
- 59 7. The Petition for Review filed by petitioner on the 25th day of March 1940.
8. This Præcipe.

J. G. KORNER, Jr.,
J. G. Korner, Jr.,
Transportation Building, Washington, D. C.,
Attorney for Petitioner-Appellant.

Of Counsel:

H. G. HUDSON,
Wachovia Bank Building, Winston-Salem, N. C.
STRATTON COYNER,
Reynolds Building, Winston-Salem, N. C.

Service of the above Præcipe acknowledged this 26th day of March 1940.

J. P. WENCHEL,
J. P. Wenchel.

Chief Counsel, Bureau of Internal Revenue.

60 [Clerk's certificate to foregoing transcript omitted in printing.]

40

GUY T. HELVERING VS. RICHARD J. REYNOLDS

61

In United States Circuit Court of Appeals for
the Fourth Circuit

No. 4641

RICHARD J. REYNOLDS, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board
of Tax Appeals

Docket entries

April 22, 1940, the transcript of record is filed and the cause docketed.

Same day, original exhibits A and B are certified up.

April 24, 1940, the appearance of J. Gilmer Korner, Jr., and H. G. Hudson is entered for the petitioner.

Same day, statement of portions of the record petitioner proposes to print in appendix to brief is filed. Service acknowledged.

April 27, 1940, the appearance of Samuel O. Clark, Jr., Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, is entered for the respondent.

May 2, 1940, the appearance of J. P. Wenchel, Chief Counsel, and John M. Morawski, Special Attorney, Bureau of Internal Revenue is entered for the respondent.

62 Same day, the appearance of Stratton Coyner is entered for the petitioner.

May 21, 1940, brief and appendix on behalf of the petitioner filed.

June 6, 1940, the appearance of Joseph M. Jones, Special Assistant to the Attorney General, is entered for the respondent.

Same day, brief and appendix on behalf of the respondent filed.

June 21, 1940, reply brief on behalf of the petitioner filed.

Argument of cause

June 28, 1940 (June term, 1940), cause came on to be heard before Soper and Dobie, Circuit Judges, and Chesnut, District Judge, and was argued by counsel and submitted.

July 3, 1940, supplemental memorandum on behalf of petitioner filed.

63 In United States Circuit Court of Appeals, Fourth Circuit

No. 4641

RICHARD J. REYNOLDS, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of
Tax Appeals

(Argued June 28, 1940. Decided October 7, 1940)

Before Soper and Dobie, Circuit Judges, and Chesnut, District
Judge

J. Gilmer Korner, Jr., and H. G. Hudson (Stratton Coyner on brief) for Petitioner, and Joseph M. Jones, Special Assistant to the Attorney General, (Samuel O. Clark, Jr., Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, on brief) for Respondent.

Opinion

Filed October 7, 1940

64 SOPER, Circuit Judge:

On April 4, 1934, the taxpayer, Richard J. Reynolds, received certain securities from a trustee in accordance with the terms of the will of R. J. Reynolds, his father, who died on July 19, 1918. Later in 1934 the taxpayer sold some of the securities at a profit; and the question is whether, in ascertaining the cost basis under the taxing statute of that year, the securities were acquired when he received them from the trustee, or when his father died and the will became effective. The Commissioner of Internal Revenue asserted that the acquisition took place upon the father's death and determined a deficiency of \$33,878.61. From the approval of this determination by the Board of Tax Appeals, the taxpayer appealed.

The will directs that the residue of the estate shall be divided by the executor between the wife of the testator and his children living at his death and the living issue of any deceased child, per stirpes; i. e., one-third to the wife and two-thirds to the children and the issue of any deceased child, to be equally divided among them, share and share alike, but subject, as to the two-thirds of the residue left to the children, to the following trust: The children's

shares are devised and bequeathed to the Safe Deposit and Trust Company of Baltimore as trustee, to collect therefrom for their equal benefit all the income until they severally arrive at the age of 21 years, meanwhile making necessary payments out of the income to the widow for the support and education of each of the children. The trustee is further directed to pay to each child between the ages of 21 and 28 certain monies out of his or her share of the income, and to accumulate the balance of the income for his or her benefit "until he or she shall respectively attain the age of 28 years when each of them shall become entitled to and shall respectively receive from said trustee his or her share of the corpus of my estate, together with the accumulated income aforesaid."

The will also provides that if any of the children should die before he arrives at the age of 28 years, then his share of the estate shall be further held in trust for the benefit of his devisees by will until he would have arrived at the age of 28 years if he had lived, when the trust shall cease and the estate shall become payable to his devisees; and if any of the children should die before arriving at the age of 28 years, without having made a will but leaving issue, then his share shall be held in trust for the benefit of his children until he would have reached the age of 28 years had he survived, when the trust shall cease and the estate shall become vested in his children; and if any of the testator's children should die without a will and without issue living at the termination of the trust, then his share shall be held in like trusts for the surviving children.

In effect, two-thirds of the residue of the estate is devised and bequeathed to a trustee to divide it into as many shares as there were surviving children, the trustee to collect the income from each share and pay over a portion thereof to the child or for his benefit, and to accumulate the rest of the income until the child should reach the age of 28 years and then to pay over to the child the accumulation and the share of the corpus; but if he should die before the age of 28 years, then his share should be paid to his devisees, or if no will, to his surviving children, and if no will or children, then to the surviving children of the testator. Thus the corpus of two-thirds of the residue of the estate was devised in trust to an indefinite class of persons, but no member of the class was to take a part of the corpus unless he should reach the age of 28 years.

The trustee received the trust properties from the executor of the estate in 1926; and on April 4, 1934, when the taxpayer became 28 years of age, distributed to him his share, including the securities sold by him in the taxable year. Some of these securities had been received by the trustee from the decedent's

estate and others had been acquired by the trustee in intermediate transactions under the terms of the will. The Commissioner, in computing the taxpayer's gain upon the sale of the securities, used as the basis the value of the securities at the time of the testator's death as to those then held by him, and the cost of the securities to the trustee as to those which it acquired thereafter. The position of the taxpayer before the Board of Tax Appeals and before this court is that since he did not become entitled to the property until April 4, 1934, he did not acquire any of it prior to that date within the meaning of the statute.

The Revenue Act of 1934, Ch. 277, 48 Stat. 680, 26 U. S. C. A. 113, provides:

"§ 113. Adjusted basis for determining gain or loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

(5) Property transmitted at death.—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

The decision of the Board is in harmony with Art. 113 (a) (5) of Treasury Regulations 86, promulgated under the Revenue Act of 1934:

"Art. 113 (a) (5)—1.—Basis of property acquired by bequest, devise, or inheritance.—(a) Property included.—Section 113 (a) (5) applies—

(1) to all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; and

67 (2) to property passing under an instrument which, under section 113 (a) (5) is treated as though it were a will, but applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(b) Basis.—Under the law governing wills and the descent and distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise. Pursuant to this rule of law, section 113 (a) (5) prescribes a single uniform basis rule applicable to all property passing from a decedent by will or under the law governing the descent and distribution of the property of decedents. Accordingly, the time of acquisition of such property is the death of the decedent, and its basis is the fair market value at the time of the decedent's

death, regardless of the time when the taxpayer comes into possession and enjoyment of the property. * * *

It will be perceived that under this regulation the time of acquisition of property passing from a decedent by will is the date of the decedent's death, whether the interest of the recipient is vested or contingent. The taxpayer concedes that the title to a vested interest relates back to the death of the decedent; but he contends that he was left only a contingent interest by his father's will, and that such an interest is not acquired within the true meaning of the statute until the contingency takes place. We must therefore first inquire whether the interest of the taxpayer under his father's will was vested or contingent, and the answer must be found in the law of North Carolina. *Blair v. Commissioner*, 300 U. S. 5, 9; *Uterhart v. United States*, 240 U. S. 598; *Lane v. Corwin*, 2 Cir., 63 F. 2d 767, 769; *Pringle v. Commissioner*, 9 Cir., 64 F. 2d 863, 864; *Becker v. Anchor R. & I. Co.*, 8 Cir., 71 F. 2d 355, 357; *Warner v. Commissioner*, 2 Cir., 72 F. 2d 225, 227; *Roebling v. Commissioner*, 3 Cir., 72 F. 2d 444, 446; *Forbes v. Commissioner*, 1 Cir., 82 F. 2d 204, 206; *Twining v. Commissioner*, 2 Cir., 83 F. 2d 954, 955.

The rule in North Carolina in respect to what constitutes a vested as distinguished from a contingent remainder is in general the same as that of the common law. *Hooker v. Bryan*, 140 N. C. 402, 404. In many instances, as in the case at bar, the question arises with reference to an estate in remainder which is conditioned upon a time element. In such a situation the rule is that if the time specified is annexed to the payment only, the gift vests immediately; but where the time is annexed to the gift itself, as when it goes to the legatee when he arrives at a certain age, the bequest does not vest unless and until he arrives at that age. In applying the rule it should be borne in mind that the law favors the vesting of estates, and that a vested interest may be created by language clearly indicating an intent that a definite person shall receive the property, although the instrument subsequently provides that the gift shall not take effect unless a certain condition, such as the arrival of the beneficiary at a certain age, is fulfilled. Obviously the application of the rule is attended with difficulty and the distinctions drawn in the adjudicated cases, even in the same jurisdiction, are not always clear.

In a number of North Carolina cases, a conditional element of time in testamentary dispositions has been held to create a contingent interest, as where a legacy is given to a person when he arrives at his majority. *Kent v. Watson*, 17 N. C. 366; *Giles v. Franks*, 17 N. C. 521; *Gill v. Weaver*, 21 N. C. 41; *Anderson v. Felton*, 36 N. C. 55; *Whitesides v. Cooper*, 115 N. C. 570; *Freeman v.*

Freeman, 141 N. C. 97; McRae v. Commerce Union Trust Co., 199 N. C. 714; Knox v. Knox, 208 N. C. 141. In other instances, the intent to create a present vested interest was thought to be so clear that the time condition did not introduce a contingency, but at most, made provision for a subsequent divesting of the property in case the condition should not be met. Cooper v. Pridgeon, 17 N. C. 98; Hooker v. Bryan, 140 N. C. 402; Ziegler v. Love, 185 N. C. 40; Henderson v. Western Carolina Power Co., 200 N. C. 443; Hood v. McElvain, 215 N. C. 568. The criterion, of course, is the intent of the grantor or testator. As was said in Freeman v. Freeman, 141 N. C. 97, at p. 99:

"The rule itself is always subservient to the intention of the testator; and therefore, if upon construing the whole will, it clearly appears that the testator meant the time of payment to be the time when the legacy should vest, no interest will be transmissible to the executors or administrators if the legatee dies before the period of payment. * * * For if the testator thinks proper to say distinctly that his legatees, general or residuary, shall not be entitled to the property unless they live to receive it, there is no law against such intention if clearly expressed. 2 Wms. on Executors, 520-1."

Applying these rules to the Reynolds case, it seems clear that it was the intention of the testator to divide two-thirds of the remainder of his estate into as many portions as there were children surviving at the time of his death, and to give to each child a part of the income from one share until he reached the age of 28 years, but to withhold the income accumulated in the meantime and the corpus of the share until he should reach the age of 28 years; so that unless he should attain that age, he would not be entitled to receive this property at all. This condition, it seems to us, was annexed to the gift itself in such a fashion as to create a contingent interest within the rule as illustrated by the North Carolina decisions. See also Roebeling v. Commissioner, 3 Cir., 78 F. 2d 444; Beers v. Commissioner, 3 Cir., 78 F. 2d 447; Forbes v. Commissioner, 1 Cir., 82 F. 2d 204.

The problem is simplified in the pending case by decisions in the North Carolina courts relating to the Reynolds will and discussing the nature of the interest held by the taxpayer and by his brother,

Z. S. Reynolds, under the will during the period between the ages of 21 and 28 years. In Reynolds v. Trust Co., 201

N. C. 267, the court considered an application made by Richard J. Reynolds, the taxpayer herein, after reaching the age of 21 years, to receive from the trustee of the estate double the amount made or saved by him in a year, under a provision of the will which directed the trustee to pay to any child between the ages of 21 and 28 two dollars for each dollar that he had made by indi-

vidual effort in any legitimate business or investment, or had saved from money, stocks, or bonds owned by him. Richard J. Reynolds, in computing his savings in the particular year, included in his income the sum of \$50,000 allowed him annually under the will between the ages of 21 and 28 from the income on the trust estate set up for his benefit. He took the ground that he had a vested interest in and therefore owned the property from which the income was derived, subject only to a divestment by death before arriving at the age of 28 years; and hence so much of the \$50,000 as he did not spend represented savings from money owned by him. The Supreme Court of North Carolina, without expressly characterizing the interest as vested or contingent, rejected the petitioner's contention and held that the income received from the trustee was not derived from monies or property owned by the taxpayer, and also held that the purpose of the testator to encourage habits of thrift on the part of his children would not be served by treating part of this income as money the taxpayer had made or saved through his own individual effort.

This decision was discussed by the Superior Court of Forsyth County and by the Supreme Court of North Carolina in *Reynolds v. Reynolds*, 208 N. C. 578, wherein was considered a petition to set aside a contract of settlement which made provision for Anne Cannon Reynolds II, a child of Z. S. Reynolds and his divorced wife Anne C. Reynolds. Z. S. Reynolds died before he reached the age of 21. The case arose after his second marriage and death, and after the posthumous birth of Christopher
71 Smith Reynolds, a son by the second marriage. The interested parties were joined in the proceeding and the court was called upon to consider among other things the validity of the divorce, the validity of a will of Z. S. Reynolds, and the validity and fairness of the prior settlement for the benefit of the child of the first marriage. Ultimately the court approved a compromise settlement wherein it was agreed that out of the Z. S. Reynolds' share of the estate, divers payments should be made to his children, his second wife, and his brother and sisters.

During the pendency of the proceeding, the State of North Carolina was allowed to intervene and assert a claim for inheritance taxes on the share of Z. S. Reynolds in the estate. The State claimed that under the R. J. Reynolds' will, Z. S. Reynolds took a vested interest in a share of the estate and that the transfer of this interest upon his death gave rise to inheritance or succession taxes for which the State Commissioner of Revenue had levied an assessment. The court was petitioned to determine the exact amount of the taxes due and to decree that they be paid from the property in the hands of the trustee. The other parties to the cause, including the guardians of the infant children, the

brother and sisters of Z. S. Reynolds, and the trustee under the will of R. J. Reynolds, took issue with the claim of the State of North Carolina and averred that as Z. S. Reynolds died before he was 28 years of age, no part of the trust estate created by the will of his father, and no part of the accumulated income vested in him, and therefore no part thereof was transferred from him upon his death in such a way as to become subject to an inheritance or succession tax.

The brother and sisters of Z. S. Reynolds, however, proposed a settlement of all claims of the State of North Carolina for taxes in the sum of two million dollars, to be paid out of the share of Z. S. Reynolds; and this proposal of compromise was considered by the court in connection with the compromise settlement affecting the claims of the various parties interested in the estate. The court, having considered the will of R. J. Reynolds, held that thereunder Z. S. Reynolds did not acquire any vested interest in the trust estate or in the accumulated income, and that none of it would have vested in him unless and until he arrived at the age of 28 years. In reaching this conclusion, the court referred to the fact that in *Reynolds v. Trust Co.*, 201 N. C. 267, the point was raised that the similar interest of Richard J. Reynolds under the will was a vested interest, but that the petition for increased allowance based on this assumption had been rejected. The court also referred to the uncertainty of the application of the State statute in the event of the nonexercise of a power of appointment. Finally the court approved the proposed compromise of the claim of the various parties interested in the estate of Z. S. Reynolds, including the claim of the State of North Carolina for taxes, on the ground that the settlement proposed was for the best interests of the infants and of all of the parties, recognizing that the claims of the interested parties, including that of the State, presented difficult questions likely to result in long, expensive, and uncertain litigation. An appeal was taken from the judgment of the Superior Court, but it was approved by the Supreme Court in *Reynolds v. Reynolds*, 208 N. C. 578. It thus appears that the precise point at issue in the pending case as to the quality of the interest of Z. S. Reynolds and of R. J. Reynolds, the taxpayer herein, was considered by the Superior Court of Forsyth County, and that it was definitely decided that the interest was contingent and not vested.

The inquiry in its final aspect is whether the date of acquisition by the legatee of a contingent remainder within the meaning of § 113 (a) (5) of the Act of 1934 is the date of the testator's death or the date of the event upon which the remainder becomes vested.

Strong light is thrown upon this question by the legislative history of the revenue acts, because § 113 (a) (5) of

the Act of 1934 is substantially the same as the corresponding sections of prior acts, i. e., § 202 (a) (3) of the Act of 1921, § 204 (a) (5) of the Act of 1924, and § 204 (a) (3) of the 1926 Act. It is important to ascertain how these prior statutes have been construed by the Treasury Department and by the courts.

In 1920 the Treasury Department, recognizing the distinction between vested and contingent remainders, held that if the interest of a remainderman in the property bequeathed by the will is contingent only prior to the death of the life tenant, the basis for determining gain or loss from the sale of the property by the remainderman is its value on the date of the death of the life tenant. O. D. 727, C. B. 53. Again in 1932 the General Counsel of the Bureau of Internal Revenue stated that the position of his office had been that one who has a mere contingent interest in property does not acquire the property until his interest becomes vested. G. C. M. 10260, C. B. XI-1, 79, 80.

The same conclusion was reached in the decisions of the courts which were called upon to interpret the earlier acts. In *Pringle v. Commissioner*, 9 Cir., 64 F. 2d 863, cert. denied 290 U. S. 656, wherein the Revenue Act of 1921 was interpreted and applied, the will of the testatrix created a trust for a period of 25 years from the birth of the youngest child living at her death, and provided that upon the termination of the trust the property should be distributed among such of the children as should be then living, the issue of a deceased child to take the parent's share, and if no issue, the whole to go to the survivors. Holding that the remainder was contingent under the State law the court said: (p. 864)

"It is not question that a person can not be said to have 'acquired' property within the meaning of the Revenue Act, § 202 (a) (3) supra, before he has some substantial ownership therein. If his interest is contingent upon the happening of some future event, until the happening of that contingency when his
74 interest becomes vested, he has merely a possibility of acquiring an estate and can not be said to have any substantial ownership therein. The rulings of the Department of Internal Revenue have consistently been to the effect that where one has merely a contingent interest in property he does not 'acquire' that property until his interest becomes vested * * * .

Petitioners' interests in the property becoming vested on July 25, 1923, it was on that date that they 'acquired' the property within the meaning of § 202 (a) (3) of the Revenue Act of 1921, supra, and the value of the property on that date should have been taken as the base for determining the gain or loss from the sale. * * *

The cases of *Brewster v. Gage*, 280 U. S. 327, and *Chandler v. Field* (C. C. A. 1), 63 F. 2d 13, are not controlling here. In each of those cases the interest of the taxpayer became vested immediately upon the death of the testator."

In *Lane v. Corwin*, 2 Cir., 63 F. 2d 767, cert. denied 290 U. S. 644, under the Revenue Act of 1928, a somewhat similar testamentary provision was considered. The court said: (p. 770)

"Since the interest of the appellants was merely contingent and not vested, they should not be considered as having acquired the property at the time of the death of the testatrix. The will gave the realty to the trustees in the manner described without any remainderman being stated as part of the trust provisions. A later clause in the will stated that upon termination of the trust 'each of my surviving sons shall become seized absolutely of an undivided one-fourth interest in such real estate as may be then held in trust; the one-fourth interest of any of my sons who shall have died prior to or contemporaneously with the termination of such trust shall pass absolutely to his issue, if any, per stirpes. In default of such issue, such portion shall pass absolutely to his heirs as determined by the statutes of New York as to real property.'"

The complete enjoyment of the real estate could be obtained only after satisfying both the contingency of the
75 termination of the trust and the contingency of the survival of the sons after the termination of the trust. This interest is not substantially a specific or general devise within the first sentence of § 113 (a) (5). Therefore it falls within the third sentence of the statute, and the date of acquisition by the deed is the basis upon which to determine the cost to appellants."

See also *Becker v. Anchor R. & I. Co.*, 8 Cir., 71 F. (2d) 355, and *Forbes v. Commissioner*, 3 Cir., 82 F. (2d) 204. The converse of the rule, where the remainder under consideration was vested, was applied in *Brewster v. Gage*, 280 U. S. 327, where it was held that within the meaning of the Revenue Acts of 1918 and 1921 the time of acquisition by a residuary legatee of his interest in the estate of the testator was not the date of distribution but the date of the testator's death; and the same rule was applied in *Chandler v. Field*, 1 Cir., 63 F. 2d 13, cert. denied 289 U. S. 758; *Huggett v. Burnet*, App. D. C., 64 F. 2d 705; *Molter v. Commissioner*, 7 Cir., 69 F. 2d 7; *Hopkins v. Commissioner*, 7 Cir., 69 F. 2d 11; *Warner v. Commissioner*, 2 Cir., 72 F. 2d 225, cert. denied 293 U. S. 620; *Roebling v. Commissioner*, 3 Cir., 78 F. 2d 444; *Beers v. Commissioner*, 3 Cir., 78 F. 2d 447, cert. denied 296 U. S. 620; *Twining v. Commissioner*, 2 Cir., 83 F. 2d 954, cert. denied 299 U. S. 578.

All of these cases arose under the Acts of 1921, 1924, or 1926, which were similar in this respect to the Act of 1934 now before

the court, except *Lane v. Corwin*, *Becker v. Anchor R. & I. Co.*, *Forbes v. Commissioner*, and *Twining v. Commissioner*, which arose under the Act of 1928. That Act and the Act of 1932 were couched in language that differed from the prior and subsequent legislation. § 113 (a) (5) of the Revenue Act of 1928 and of the Revenue Act of 1932 provided in part as follows:

“Property Transmitted at Death. If personal property was acquired by specific bequest, or if real property was ac-
 76. quired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.”

Although the language is changed, the word “acquired” is used in these intervening Acts, and therefore decisions interpreting the word as used therein are relevant. In addition to the decisions of the Circuit Courts of Appeals above referred to, reference may also be made to *Helvering v. San Joaquin Co.*, 297 U. S. 496, dealing with the Revenue Acts of 1921, 1924, 1926, and 1928, where it was held that real property was “acquired” within the meaning of these statutes under a lease containing an option to purchase not when the lease was made but when the option was exercised, the court saying: (p. 499)

“If we should agree that a lessee-optionee acquires, by virtue of the instrument, an equitable interest in the land, it would not follow that, within the contemplation of the revenue acts, he acquires the property at the date of the option rather than at the date of conveyance. The word “acquired” is not a term of art in the law of property but one in common use. The plain import of the word is “obtained as One's own.” Language used in tax statutes should be read in the ordinary and natural sense. In the common and usual meaning of the term, the land was acquired when conveyed to the respondent's predecessor.”

If we apply the definition of the word “acquired,” as given by the Supreme Court, it seems clear enough that the taxpayer did not acquire or obtain the property “as his own” until the contingency happened which made his ownership definite and certain. See also *McFeely v. Commissioner*, 296 U. S. 102.

77 The reenactment of the section in 1934 in substantially the same words as the earlier statutes is of great significance

in view of the fact that a number of the cited decisions interpreting the term "acquired" had already been handed down when the statute was passed. It is a "familiar rule that where words are employed in an act which had at the time a well-known meaning in the law, they are used in that sense, unless the context requires the contrary"; *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 115; and when a statute has been amended from time to time and language which has been construed by the courts is retained, it must be assumed that Congress is satisfied with and has adopted the construction given by the courts. *Electric Battery Company v. Shimadzu*, 307 U. S. 5, 12; see also *Copper Queen Cons. Mining Co. v. Arizona*, 206 U. S. 474; *Commissioner v. Winmill*, 303 U. S. 79.

It is of interest that as late as November 24, 1939, the Board of Tax Appeals in *Van Vranken v. Commissioner*, 40 B. T. A. 955, pointing out that the provisions of the Revenue Act of 1934 were similar to the Revenue Acts of 1921, 1924, and 1926, cited the decisions interpreting the earlier acts, and held that the date of acquisition of the interest of the remainderman depends upon whether the interest is vested or contingent. This position was reversed by the Board in *Augustus v. Commissioner*, 40 B. T. A. , decided December 20, 1939, and *Archibald v. Commissioner*, 40 B. T. A. , December 22, 1939. The Commissioner of Internal Revenue changed his position in 1935 upon the promulgation by the Treasury Department of Regulations 86, Art. 113 (a)

(5) (b) which, as we have seen, provides that "all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent even though the interest of him who takes the title was, at the date of the death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise." Obviously this regulation

amounts to an unwarranted amendment of the Act of 1934 if we are right in our assumption that this Act should be given the same interpretation as its predecessors of similar import. It is, of course, immaterial that the regulation does not favor the government at the expense of the taxpayer, or that it makes for uniformity, simplicity, and ease of administration. "We ought not to depart from the plain meaning of the section in an effort to bring about a uniformity which it is claimed Congress intended, but failed to express." *McFeely v. Commissioner*, 296 U. S. 102, 111.

The Commissioner, however, asserts that the circumstances under which the Act of 1934 was passed clearly indicate an intent on the part of Congress to provide a uniform basis for all interests passing under a will, whether vested or contingent. The burden of the argument is that when the Act was under consideration, the

attention of Congress was called to the decision of *Brewster v. Gage*, 280 U. S. 327, and that Congress understood it to hold that under the Acts of 1918 and 1921, the time of acquisition of all property passing by bequest, devise, or inheritance, was the date of the testator's death. It is not denied that the decision was limited to a vested interest, but it is said that the statutory language must be given the meaning which, as Congress believed, had been attributed to it by our highest court.

An examination of the circumstances prior to and attendant upon the passage of the Act of 1934 does not support the Commissioner's contention. The reports of the Committees of the 70th Congress, 1st Session (Ways & Means Committee of the House, Report No. 2, p. 18; Finance Committee of the Senate, Report No. 960, p. 26), show that the change in the 1928 Act was brought about by dissatisfaction with the decision in *McKinney v. United States*,¹ 62 Ct. Clms. 180, cert. denied 273 U. S. 716, wherein it was held that the basis for determining gain or loss on a sale by an executor is the cost of the property to the decedent. The House preferred the rule that the basis in such a case should be the value at the time of the decedent's death, and proposed broadly that the value at that time be adopted as the basis for property acquired by bequest, devise, or inheritance or by the deceased's estate from the decedent. Such a provision, if adopted and continued in the taxing statutes, would have accomplished the result for which the present regulation was designed; but the Senate refused to concur, pointing out that the proposal would not cover the sale of property purchased by an executor. The Senate proposed the language finally embodied in the Act of 1928 and repeated in the Act of 1932. The rule of *McKinney v. United States* was rejected, and a new section under the caption "Property Transmitted at Death" was enacted, wherein it was provided that in the case of property acquired by general or specific devise, or by intestacy, and in the case of property acquired by will or intestacy, the basis should be the value at the time of distribution to the taxpayer. When this new section came before the courts, it was held, as we have seen (*Lane v. Corwin*, *Becker v. Anchor R. & I. Co.*, and *Twining v. Commissioner*), that a contingent interest of a beneficiary in property devised to a trustee is not a devise to the beneficiary within the meaning of the statute, and that upon the subsequent sale of the property by the beneficiary, the basis is the value at the time of distribution; and the distinction between vested and contingent remainders in applying the statute to specific cases was preserved.

¹In 1935 the ruling of this case was disapproved in *Hartley v. Commissioner*, 285 U. S. 216.

These acts were in force in 1933 when Congress came to consider the Act of 1934. The Ways & Means Committee of the House (House Report 704, 73rd Congress, pp. 27-8), noted the lack of uniformity in the treatment of general as compared with special bequests of personal property in the Acts of 1928 and 1932, and said that since the 1928 Act was passed, the Supreme Court in *Brewster v. Gage* had defined the date of acquisition to mean the date of the death of the decedent in the case of all property passing by bequest, devise and inheritance, whether real or personal; and the committee therefore recommended that the language of the Act of 1932 be changed as to conform to the Act of 1926, "so that a uniform basis rule may be required in case of property passing at death whether real or personal."

This comment upon the decision in *Brewster v. Gage* was correct if it be taken to mean that therein no distinction was made between real and personal property; but it was not correct if it intended to say that the decision recognized no distinction based upon the nature of the estate created by the will of the deceased. The decisions of the courts (see *Lane v. Corwin*, *Chandler v. Field*, *Pringle v. Commissioner*, *Huggett v. Burnet*, *Hopkins v. Commissioner*, and *Beers v. Commissioner*), show that in *Brewster v. Gage* the court was concerned only with a vested interest. Moreover, it was made clear to the House Committee by representatives of the Treasury Department that the decision covered only one or two points, and that while the proposed amendment would eliminate some of the distinctions in the Act of 1928, it would not produce a uniform rule applicable to all situations. Our conclusion is that we are not warranted in departing from the general rule that where words are employed in one Act which had acquired a well-known meaning in the law, they are to be given the same significance when used in a later statute. The history of the legislation under consideration does not reveal that Congress in re-enacting in 1934 the language contained in the Acts of 1921, 1924 and 1926, intended that it should have a significance different from that attributed to it by the courts in construing the earlier acts.

It is suggested that a very definite trend to get away from the nice distinctions of the law of property in applying federal statutes of taxation is apparent in recent cases. For example, in *Helvering v. Hallock*, 309 U. S. 106, the federal estate tax enacted by the Revenue Act of 1926 was held to cover not only interests which passed at death, according to the strict technicalities of the law of property, but also transfers inter vivos clearly akin to testamentary dispositions. Undoubtedly the distinction between vested and contingent remainders is of like technicality; and if we were free to treat the question of statutory

interpretation in this case apart from its legislative history, considerations of uniformity and simplicity would be entitled to great weight. But the doctrine that reenactment of a statute impliedly adopts a settled judicial construction of the language employed was again recognized in the cited case (p. 120, n. 7), and although it was there thought to be irrelevant, its bearing here in the light of the legislative history of the statute is manifest. One practical consideration that may distinguish the situation in the pending case from that before the court in *Helvering v. Hallock*, is that an interpretation of the Act of 1934 in harmony with that given to the prior acts of like import is no more likely to benefit the taxpayers than the government.

We reach the conclusion that the correct basis for the calculation of the gain or loss of the taxpayer is the value of the securities when distributed to him by the trustee. Certain of these securities were owned by the decedent at the time of his death, and having passed under the will to the trustee, were retained by it until distribution to the taxpayer. Other securities distributed to the taxpayer when he reached the age of 28 years had been purchased by the trustee in the exercise of its power of administration of the trust. The Commissioner contends that the latter securities did not constitute property "acquired by bequest, devise, or inheritance" within the meaning of § 113 (a) (5) of the Act of 1934, and that the basis thereof was the cost of the securities to the trustee. The Commissioner points to no provision of the statute, other than § 113 (a) (5) as applicable to such a situation, but suggests that it is covered by Regulations 86, Article 113 (a) (5)-1 (a) which provides in part that if the property is an investment by the fiduciary under a will "the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent died." This regulation, however, seems to have no relevancy to the instant case since it is entitled "Property Acquired before March 1, 1913; Reinvestment by Fiduciary," and expressly refers to the case of a decedent who has died before March 1, 1913. We recur to the statute for there is no reason to believe that Congress, in covering other contingencies, made no provision for the basis of securities purchased by a trustee under a will and subsequently passing to a beneficiary. In our opinion, § 113 (a) (5) of the Act covers securities purchased by the trustee in the administration of the estate and distributed to the taxpayer, as well as securities received by the trustee from the decedent's estate and similarly distributed. Obviously the will of R. J. Reynolds was the source of the taxpayer's acquisition in both cases. We are in accord with the views expressed upon a similar question under the Revenue Act of 1928 in *Commissioner v. Gambrill*, 2 Cir., 112 F. 2d 530, 533. Cf. *Commissioner v. McGuire*, 7

Cir., 111 F. 2d 843. We conclude that the basis for determining gain to the taxpayer is the same as to both classes of securities: (1) those owned by the testator at the time of his death, and (2) those purchased by the trustee. This basis is the fair market value of the securities at the time they were distributed by the trustee to the taxpayer, when the interest of the taxpayer therein that, up to that time, had been contingent, became absolute and vested.

The order of the Board of Tax Appeals is reversed, and the case is remanded for further proceedings.

Reversed and Remanded.

83 In United States Circuit Court of Appeals, Fourth Circuit

No. 4641

RICHARD J. REYNOLDS, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

Judgment

Filed and Entered October 7, 1940

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals for further proceedings in accordance with the opinion of the Court filed herein.

MORRIS A. SOPER,
U. S. Circuit Judge.

October 7, 1940.

Recital as to issuance of mandate

On another day, to wit, November 7, 1940, the mandate of this Court, in this cause, is issued and transmitted to the United States Board of Tax Appeals, at Washington, D. C., in due form.

Same day, the original exhibits A and B are returned to the clerk of the United States Board of Tax Appeals.

[Clerk's certificate to foregoing transcript omitted in printing.]

In Supreme Court of the United States

Stipulation re exhibits

It is hereby stipulated and agreed by and between the attorneys for the respective parties that the original Exhibits A and B (duly certified as such by the Clerk of the United States Board of Tax Appeals), which are referred to in Paragraph 3 of the Stipulation of Facts (*supra*, —) filed with the Board on April 12, 1939, and which exhibits were returned to the Clerk of the Board by the United States Circuit Court of Appeals for the Fourth Circuit on November 7, 1940, i. e., the day on which that court issued and transmitted its mandate to the Board (*supra*, —), may be filed with the Clerk of the Supreme Court of the United States and considered by that Court as a part of the certified record.

86 in the case.

Because of the voluminous character of these exhibits printing thereof is waived and may be dispensed with unless required by the Court.

A copy of this stipulation may be printed as an appendix to the record.

FRANCIS BIDDLE,
Solicitor General.

J. G. KORNER, Jr.,
Attorney for the Respondent.

Dated December 27, 1940.

Supreme Court of the United States

Order allowing certiorari

Filed February 17, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted, limited to the questions presented by the petition, with the exception of the question whether the remainder was vested or contingent under the law of North Carolina.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.